THE INDIAN MONETARY POLICY

B. P. ADARKAR

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THE INDIAN MONETARY POLICY

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The Indian Monetary Policy

By

B. P. ADARKAR, M.A., (CANTAB.)

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TO

PANDIT AMARANATHA JHA

VICE-CHANCELLOR, ALLAHABAD UNIVERSITY

IN GRATITUDE

FOR HIS INTEREST IN MY WORK

PREFACE

FOR a layman to have his say in matters reserved for experts and specialists is a dangerous venture. In the modern world, currency and finance are, like the ancient mysteries, a close preserve for the elect. And yet they govern our destiny far more than the gods of old did when the world was young. Howsoever intricate and mysterious they might be, we must understand them; for if we ignore them, we do so at our peril. The controversy about the *ratio* has been with us now for many years and it has become an urgent problem for the State and the people. Professors and economists may argue and quarrel about the theory of it, but the burden of the present *ratio* falls in practice upon our people and our industry and agriculture. The argument still goes on but there are few major questions in India on which there has been such a consensus of opinion and such a unanimity of opposition to the policy of the Government of India. Most experts oppose this policy; Indian business men and manufacturers, having themselves suffered greatly under it, are bitter at its

continuance; and the National Congress has again repeated in emphatic language its condemnation of it and demanded a change. I have no doubt in my own mind that the artificially fixed exchange value of the rupee has injured not only our industry but also the mass of our agriculturists.

But the question now before us is not merely one of fixing one and four pence as the value of the rupee. It is doubtful if even that will meet the requirements of to-day, and it might be necessary to fix a lower figure. We have had our finances and currency juggled far too long in the interests of British vested interests. The time has come when this must end, however much the British Government might object.

I am glad that Mr. Adarkar has written this book and I hope that many will read it and thus gain an understanding of this important problem.

Allahabad
January 9, 1939

JAWAHARLAL NEHRU

INTRODUCTION

FROM the point of view of the larger economic interests of India, the ratio question is of considerably less significance than the question of the appropriate monetary standard to be adopted. It has by now become a common place of currency literature that for a country which has a wider ambit of internal than of external trade, mere exchange stability, which is secured regardless of internal stability of production, prices and employment, is not a proper justification for a standard. For this reason, so far as the question of the appropriate standard is concerned, it is beyond the shadow of a doubt that an independent standard is to be preferred to an exchange standard in the case of India. In spite of this, India has had an exchange standard of one kind or another almost since the very beginning and under various pretexts, while now finally the sterling exchange standard has been adopted in its purest form, in the teeth of opposition of Indian interests. However, it is not the sterling standard so much as the exchange ratio associated with the sterling link which has caused more bad blood than anything else in the monetary history of India. It

is obvious that so long as the sterling nexus continues, the ratio will continue to dominate all other considerations in the shaping of a monetary policy for India. The controversy is not, therefore, dead.

Theoretically, the exchange problem is one of the most interesting topics in monetary literature and has rightly received its proper share of attention from high authorities such as Keynes, Cassel, Ohlin and others. The central issue in the discussions has always been the concept of an "equilibrium" or "natural" or "normal" ratio,[1] and the Indian exchange problem has presented itself as one of the most intricate applications of the doctrine in this regard. However, when the fate of the rupee was irrevocably decided in the year 1924 (*de facto*) and in 1926 (*de jure*), the purchasing power parity doctrine reigned supreme. In spite of technical criticism by Keynes and others, the truism as well as the fallacy of that doctrine dominated discussions on exchange policies, so that it was ever possible for the protagonists as well as the opponents of the 18*d.* ratio to prove their "cases" to their own satisfaction. However, much water has flowed down the bridge since then and foreign exchange theory has

[1] I have considered this question at considerable length in my book, *The Theory of Monetary Policy* (P. S. King, London, 1935).

made great strides. This is another reason why the ratio controversy may legitimately be opened up again. Lastly, one more reason for re-opening the issue is the fact that a good deal of *post-facto* material, mainly of a statistical nature, has been made available in recent years.

I am aware that much more could have been said on the ratio and on the monetary policy of the Government of India and a much deeper analysis made of the outstanding facts and figures than what I have attempted in this book. However, the subject-matter of this book is based upon a recent series of articles contributed by me to the *Indian Finance* of Calcutta, the main purpose of which was to discuss this problem anew in as non-technical a manner as possible. Thus, this book is addressed to the general public, including students, commercial men and politicians, rather than to that section of the faculty of economists who are accustomed to harder thinking. Elsewhere, in economic and statistical journals, I have dealt more thoroughly with some of the topics discussed here; I, therefore, refer the inquisitive reader to those places.[2]

It is a sad commentary on the politico-economic situation in the country that the Government should insist on repeating the same shibboleths over and

[2] See, in particular, *Indian Journal of Economics*, July 1935 and January 1936; also *Sankhya*, November 1938; and *Indian Finance*, Reserve Bank Supplement, April 1935.

over again, although they have been refuted times without number. These shibboleths have again been fully disproved and laid low in this book. It is a happy sign that the Congress is now seised of the question, so to say, and that it is turning its attention, in an ever-increasing measure, to these problems of economic importance to the country. The ratio question, to my mind, is no longer one to be elaborately threshed out in an academical fashion; it has, on the contrary, become a purely *political* question, which has to be settled by a trial of strength, rather than by wordy argument. The supreme callousness and disregard, with which the Government has been turning down all requests even for an impartial enquiry (such as the one implicitly promised by the Preamble to the Reserve Bank of India Act), in fact, suggest that this is the only line of action invited by our monetary dictators of Simla and London. It is to be sincerely hoped that the new Democracy, which is arising in India, will strike and strike decisively at this obnoxious hegemony of London *haute finance*, and, in the not very distant future, attain that financial sovereignty, with which alone we can shape the monetary policy of India to suit the requirements of our *national* economic system and without which any political power must remain a hollow mockery.

The book could not have come out under more appropriate auspices, in view of the fore-

going remarks. I am deeply grateful to Pandit Jawaharlal Nehru for his Preface which, if I may say so, is characteristic of his dynamic mind. Thanks are due to the Editor of the *Indian Finance* of Calcutta for permission to utilise and reproduce my articles on "The Rupee Ratio Reconsidered," which recently appeared in that Journal. Kitabistan, the premier *national* publishing house of India, deserves to be congratulated on producing this little volume in such excellent style.

Allahabad University
January, 1939.

B. P. ADARKAR

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CHAPTER ONE

APOLOGIÆ OF THE GOVERNMENT

SO much has been written on the ratio question, especially in regard to its historic aspect, *i.e.*, whether the 18*d.* ratio in 1926 was or was not a deflationary and unnaturally high ratio, that one might almost despair of adding anything that would shake the unshakable self-complacencies of Simla. There are, generally speaking, three main assertions made by the Simla satraps in this connection whenever they have been nettled : (1) that the time is not yet "opportune," even to consider a revision of the ratio of the rupee policy, the "international horizon" being still not very "clear" and monetary conditions not yet very stable ; (2) that there is nothing wrong with the 18*d.* ratio or the sterling

link, but that, in fact, this is the best of all possible ratios and this is the best of all possible links; and (3) that the popular notion that any "monkeying" with the ratio would be a "panacea" for our monetary or economic ills is a misconception and a delusion. Here I propose to undertake a detailed examination of these assertions and show, if I can, that in this respect, at any rate, it is upon the sovereignty of the "sword" rather than upon the sovereignty of logic that the Government have always relied and that they are living in a monetary Bedlam of their own creation.

IS THE TIME "OPPORTUNE"?

First, then, let us address ourselves to the peculiar fetish which has gathered round a supposed necessity to consider the "clarity" of the so-called international monetary horizon and the stability of monetary conditions. It is extremely interesting how economic shibboleths of a particular type are always utilized by the Government of India to silence opposition and to side-track issues. Between 1926 and 1934, for example, the Government tenaciously adhered to the bogey of "political pressure" as something which must be avoided in the shaping of the constitution of the Reserve Bank of India. The Genoa and Brussels resolutions, that "banks of issue should be free from political interference of all kinds," were pressed

into service to stalemate the suggestion of popular representation upon the Central Board, and, contrary to the spirit as well as the letter of the very resolutions which the Government cited, the Reserve Bank was made a handmaid of the Finance Department, subject precisely to the noxious influence which the Genoa and Brussels resolutions had wholeheartedly condemned in the post-War inflationary days. Likewise, with the connivance of the London Committee on the Reserve Bank in 1932–33, a permanent hurdle in the way of the revision of the standard has been erected by fashioning in the Reserve Bank Bill, the following Preamble :—

"And whereas in the present disorganization of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system.

"But whereas it is expedient to make temporary (*sic*) provision on the basis of the existing monetary system, and to leave the question of the monetary standard best suited to India to be considered when the international monetary situation has become sufficiently clear and stable to make it possible to frame permanent measures; etc."

This Preamble to the Bill which ultimately became an Act had been inserted from the very first stage by the Government itself and was

not thrust upon an unwilling executive by a cantankerous legislature. The way, however, in which the Government has tried to hush up discussion of the currency issue—leave aside a regular enquiry into our currency requirements—suggests that the Preamble was not inserted in good faith but was always intended to serve as a useful device for shelving all proposals for revision. Even some of the best supporters of the 18*d.* ratio in 1936 (Cf. Keynes, Evidence before the Hilton Young Commission, Q. 12981, 13005; also Sir Basil Blackett himself, Minutes of Evidence, Q. 116) had visualized a situation in which, if gold prices showed a sagging tendency, the ratio could be revised in a downward direction to protect the Indian price and employment structures from collapse. It is a pity, therefore, that the Government has sacrificed India's best interests, while safeguarding sectional interests, and in the celebrated words of a former Financial Secretary (when Financial Secretaries had consciences to boast of), has "set another man's house on fire to roast its sucking pig."

As if this hurdle was not sufficient, there are further hurdles placed by the Government of India Act 1935, which requires the prior sanction of the Governor-General "in his own discretion" for the initiation of any proposal for a change in the monetary or exchange policy. It is well known that the Governor-General is not an economist,

although the surprising self-assurance, with which he has always declared that *personally* he has no doubts as to whether any change is called for, does sometimes make one pause! The Governor-General's "discretion," therefore, is the discretion of Sir James Grigg *cum* the City of London. In other words, discretion only stands for self-interest, pure and simple. There is yet another hurdle imposed by the condition (Sec. 52 of the Reserve Bank of India Act), that the Bank's Central Board should, in the first instance, report upon the advisability or otherwise of a change and upon the monetary "atmosphere." With the present composition of the Central Board, the Government can always rely upon sufficient docility on the part of the Board to prevent a precipitation of the ratio question.

THE RATIONALE OF MONETARY TRANQUILLITY

But what exactly is the point of the Preamble which has created this hurdle? Why must exchange stabilization or exchange variation take place in a period of monetary tranquillity and not in one of monetary disturbances? The vague underlying idea appears to be that comparative price equilibrium will be attained when conditions are stable, and that, by all the tokens of the Casselian doctrine of Purchasing Power Parity, such is the best time to discover the true or normal

parity for the exchanges. However, the mere fact of price indices coming together (as, for example, in 1926, British, American and Indian indices came to 160—of which Sir Basil Blackett rather illegitimately made so much to the discomfiture of his critics) does not indicate any equilibrium whatsoever. Sir Basil Blackett misled himself and others in 1926 into thinking that this was the equilibrium which was essential to exchange policy. Yet, fortunately for us and the world, this part of the Casselian doctrine has been exploded long ago. For a thorough investigation of "normal" parities, it is now necessary to investigate not only the absolute movements of indices but also the varying dynamics of different indices, the base periods, the different production and trade structures of different countries, their respective balances of payments, etc. Moreover, individual stabilisation for any country might well become the precursor of individual internal and external stability; and, in that sense, to insist upon international monetary tranquillity as a condition precedent to exchange variation is to put the cart before the horse. Not only this, but in these days of derelict currencies, manipulated exchanges, erratic stock exchanges and unorthodox Governmental finances, to ask for international monetary stability is to ask for the moon. We can assure the Government of India that, in these days, the

international monetary situation can, like the proverbial Curate's egg, be good only in parts. To insist on all-round stability will be more knavish than foolish under the circumstances.

However,—and this is the most significant aspect of the matter,—this notion of the pre-requisites of stabilisation of a national currency is itself wrong and misconceived *ab initio*. Other countries have, during the last ten years, not only stabilised but devalued, revalued and re-stabilised their exchanges in the face of the most profound international monetary disturbances. Australia, Japan, France, South Africa, the United States, Sweden and many others, undertook monetary changes of a fundamental kind not only in the midst of international confusion, but also to a large extent to *avoid the repercussions* of the international confusion and to insulate and to protect their trade, production, employment and prices from external disturbances. This is the correct function of an exchange policy as pursued by leading nations of the world intent upon national good. Contrast the consequences of the so-called exchange stabilisation, adopted by Britain in 1925 (in a tranquil period) under the Gold Standard Act of that year, with those of the new style of forced and elastic stabilisation of 1931 brought about by a much-advertised crisis; and you will recognise that exchange variation in a period of crisis can be a highly potent weapon

for protecting the national balance of payments, employment and trade. It is a curious commentary on the intellectual efficiency of the Government of India, that it is still hugging old and exploded notions of exchange management, when the other countries of the world are gravitating towards a new technique of exchange variation, within wide limits, with the aid of Exchange Equalisation Accounts, with a view to protecting their respective economic structures.

ARE MONETARY CONDITIONS UNSTABLE?

Even supposing, however, that the theory on which the Government of India has built up its false minarets of policy is the correct one, do the facts support the view of the Government that the international monetary horizon is still not clear? It is a reckless assertion to make and probably the Government believed that it was a short cut to expediency to say that the horizon is still very clouded. Yet all the statistical indicators prove that, by the end of 1936, a majority of the world's currencies had regained their stability in terms of gold. The tendency towards increasing stability of currencies which has characterised international exchange developments in recent years is illustrated in Table I below, which gives the yearly percentage range of quotations of certain currencies during 1931–37.

TABLE I

(% range of exchange variation)

	1931	1932	1933	1934	1935	1936	1937
U. S. A.	1.6	2.0	70.4	9.8	3.4	2.6	..
U. K. ..	51.2	19.5	14.9	13.1	6.7	3.4	0.6
Sweden	51.3	19.1	17.2	13.1	6.5	3.3	0.6
Norway	43.0	26.3	16.1	13.0	6.6	3.4	0.6
Denmark	53.4	26.3	28.0	12.8	7.0	3.4	0.6
Austria	21.8	18.2	14.8	2.8	5.1	3.8	0.4
Japan ..	42.7	84.8	24.4	17.0	6.5	4.4	0.4
Australia	38.9	9.2	2.2	6.0	3.5	1.9	0.7
China ..	14.6	9.7	6.6	11.5	17.3	1.3	0.4
Chile ..	..	20.5	6.0	12.6	6.3	9.8	3.6
Greece..	..	103.3	5.0	0.7	0.6	0.9	0.6

Figures are not available for France, Germany, Italy and some of the gold-bloc countries. However, barring the French franc, it can be said that, by the end of 1936, almost all of them had their currencies fluctuating within very narrow limits. Thus, from the viewpoint of exchange stability (which must even to our Government appear as the most significant indicator for exchange policy), international conditions have been exceptionally stable since 1936. If, on the other hand, we take up prices, the case is much stronger; and it can be proved that, during the last two or three years, there have been hardly any fluctuations which would be comparable with, say, periods of upheaval such as 1920-22 or 1929-31. As

regards employment and production, again, it must be admitted, since 1925 or so, times have been never more normal or stable than they have been recently. True, a recession has recently set in, but even about that there are many doubts and differences among experts. If a recession does develop into a depression, surely the Government cannot go on waiting till better times again prevail and normality is re-established. That way, we may have to wait till eternity.

As a matter of fact, whatever be the position of international currencies, there is no doubt that India is on the threshold of an insolvency so far as her external balance-sheet is concerned; her prices are again looping the loop; her Central budget is showing pitiable results; her unemployment and indebtedness are getting from bad to worse; her short-lived boom of stock-exchange prices has come to a premature end with a future full of doubts; her load of foreign debt is still as enormous as before, while her immobile capital assets of gold are being frittered away for the satisfaction of current requirements. Anyone who studies the balance of payments, including the use to which our gold assets and sterling balances are being put, must inevitably come to the conclusion that the Government of India are on the Gadarene slopes of deflation, budgetary deficits and monetary bankruptcy. But of this more

anon. In the meanwhile, one may well ask, if this is not the most opportune time for revaluation, revision or even reconsideration of our rupee policy, what is?

CHAPTER TWO

THE OBJECTIVES OF MONETARY POLICY

THE present objectives of the Government's currency policy may be grouped under three or four heads : (1) to do as little damage as possible to the British import trade, (2) to safeguard the equilibrium of the Central budget, irrespective of what happens to the Provincial, local or municipal budgets or to the budgets of thousands of commercial houses or factories, firms and private individuals, (3) to protect the sterling value of the salaries and savings of British officials in India, and (4) last but not least, systematically to flout all such public demands as are likely to conflict with the Government's *amour-propre* or high notions of prestige. Those who have always proclaimed

from housetops that reduction of the ratio would not assist Indian exports have always, in their heart of hearts, been convinced that such reduction would in effect amount to an all-round import duty on all imports and, therefore, act adversely on imports. Yet, it is not true to say that devaluation would have the necessary effect of reducing imports *en masse*. As has been widely observed (*e.g.*, Japan whose depreciation of currency resulted in an enormous growth both of imports as well as exports; so also in the case of Australia), depreciation might cause some immediate dislocation of the foreign trade, but the posterior consequences will definitely be that exports will rise to the extent of the stimulation provided by the bounty of devaluation, while latterly, owing to the improvement in the purchasing power of the masses and increased economic activity in the country, there will necessarily take place a corresponding expansion of imports.

THE TRUE ENDS OF MONETARY POLICY

Yet, apart from counterfeit ideals of monetary management, there are worthier objectives available to a Government in an enormous sub-continent like India, where there are such infinite potentialities of internal development of trade and production. The central theoretical issue in Indian currency has always been that of the "natural ratio," as

our currency has been from the very beginning an Exchange Standard, whether it was based on gold, silver or sterling. The next important issue has been whether India's choice should be exchange stability or price stability or some other criterion such as costs-prices parity. In this chapter, therefore, I propose to thresh out both the issue of the natural ratio as well as that of the correct monetary ideal for India.

We shall begin with a bird's-eye view of the leading ideas, as to what constitutes the "natural ratio," in the 1926-27 discussions. The first problem which exercised the minds of controversialists in those days was, whether the 18*d.* ratio in 1925 and thereafter assumed the position of a norm : *i.e.*, was there a mutual adjustment of the ratio and prices ? "Adjustment," however, was given a peculiar meaning. It was not realised that if the ratio is artificially raised above its, say, natural level to any extent, and kept pegged at the new level, by manipulation *à outrance*, the internal price structure, especially the wholesale part of it, is *bound* to get itself adjusted to the new ratio sooner or later. There is always a negative correlation between exchange manipulation and prices. For this reason, the so-called adjustment is possible with any ratio whatever, at some point in the course of prices, whether the ratio is above or below the norm. Thus, in the years 1922—27,

prices in India were falling gradually at times and rapidly at others—partly in sympathy with agricultural prices all over the world. We cannot, of course, just for that reason declare that the ratio was artificially high. Nor, on the other hand, can anybody assert, as the Hilton Young Commission did, that because prices had fallen in the same proportion as the ratio had risen, there was a presumption of naturalness in this. *The rupee prices would have been adjusted even to a 2s. rupee, if ruthless contraction to maintain it had been carried out.* That would not have made 2*s*. the natural level for the ratio! The point to be borne in mind is that mutual adjustment is only possible when neither the exchange nor the prices are controlled—and this could hardly ever be the case in an exchange standard management, nor was this actually the case with the rupee ratio between 1923-27.

INTERNAL AND EXTERNAL VALUE

The next criterion suggested by writers has been, whether the ratio had been adjusted to both internal and external prices. Now if by these terms, "internal" and "external" we mean respectively price levels of goods of the domestic and foreign trade of a country, then there is neither the necessity nor the possibility of these two price levels showing an exactly parallel movement over any length

of time, either due to intrinsic factors or by the action of artificial change in the exchange ratio. The two price levels correspond to two distinctive markets which are not directly and equally affected by a common cause. (Cf. Keynes, *Treatise on Money*, Vol. I, pp. 89 *et seq.*, where he points out that an initial impulse may spread disparately among the various prices which may remain for long permanently divorced from one another). It is this fallacy which has led my friend Professor P. J. Thomas, in a recent apologia of the Government's currency policy (*Economic Journal*, June, 1938) to assert that the rupee was *undervalued* as the internal prices have fallen more than the external, when he should have seen that the internal price-fall was itself the consequence of a high and pegged-up ratio and that its cure lay in bringing the ratio down! Thus, there is no sense in which we can speak of such an adjustment of the ratio to both internal and external prices. However, if by the two terms we mean prices in foreign countries and prices in our own, there is some meaning in considering a ratio-price equilibrium, but only on two assumptions: (*a*) that the prices abroad and prices at home relate to the same composite commodity of international significance, and (*b*) that the foreign countries with which the comparison is instituted, belong to the same standard. There is one fallacy, however, against which we

have to guard; thus, the mere fact that, at a certain date, the several indices came together at a definite figure does not mean anything. Sir Basil Blackett, who, in his evidence before the Hilton Young Commission, said that "British, American and Indian prices have come together at a figure of about 160," did not consider the divergent dynamics of the various indices, or the rates at which the several prices were falling. The British, American and Indian prices were not moving at the same rate and it was a merely fortuitous coincidence that the indices came together at 160. As the Commission themselves admitted (para 186), "from October, 1924 to September, 1925, there was a rapid and violent downward movement of the rupee price level *which was not the reflex* (my italics) of any similar movement in world prices." It was clear that this collapse of prices was brought about by a disastrous deflation, interpreted in the euphemistic language of "return of currency." A similar collapse of prices is incipient to-day and the Government is again talking of a "return of coin from circulation to currency."

EXCHANGE POLICY AND THE BALANCE OF PAYMENTS

Apart from these two adjustments, there is the relation between the exchange ratio and the balance of payments. It is an elementary proposi-

tion that an artificial reduction of the ratio simultaneously acts as a proportionate bounty on exports and a proportionate handicap on imports, other things remaining equal. I think both common sense and science are at one in this; yet so much has been written to show that this proposition is incorrect that one almost hesitates to say that those who deny it are merely exorcising the obvious. The negative correlation between exchange manipulation and the export series and the positive correlation between the former and the import series cannot either be clearly established or disproved by reference to facts and statistics, because the other things seldom remain the same and because it is impossible to get at figures for the situation, which would have arisen, if other things had altered but the exchange were steady. Thus, for example, statistics given by certain Indian writers to disprove this proposition in connection with India's foreign trade entirely misses the mark, because currency changes apart, the foreign trade of most countries, after the Industrial Revolution, could not have but shown a constantly upward trend. Therefore, statistics showing a *prima facie* contrariety to this proposition cannot disprove it; but if, in spite of contrary forces, exports fell and imports rose after (say) raising the ratio, this would be proof positive of the rule.

There are, however, one or two further points

which are not often well understood in this connection. Thus, very often, rising exports and falling imports bring about a rise in the exchange itself when it is not subject to manipulation; in such a case, there will necessarily be a positive correlation between exchange movement and export movements and a negative one in the case of imports. This case is clearly outside the scope of our proposition which only holds good for manipulated exchanges. The second point which I would like to raise in this regard is the fact that sometimes, owing to the choice of a very low parity for exchange, imports may be discouraged initially and exports tremendously encouraged; but the consequences of a favourable balance and more particularly of the rise of internal prices, which would come later, would be an increase of production and employment all round and a greater demand for imports (both raw materials and goods of consumption) due to that increase. Thus, the recent experience of Japan suggests that a steep depreciation of currency may, in fact, raise both imports (particularly of raw materials) as well as exports; the same is true of Australia since 1931. The conclusion of the above discussion is that an unnaturally high ratio has the dangerous capacity of turning a country's balance from a favourable into an adverse position with the attendant results of exports of gold or of securities or both.

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EXCHANGE STABILITY AND PRICES

The mutual incompatibility of exchange and price policies has been patent to even some of the diehard supporters of the 18*d.* ratio who have paid lip homage to price stability when it suited them to do so. Thus Sir J. C. Coyajee says that if the price level remained steady during 1922-24 as a result of a pegged ratio, he "would go further and assert that it was very necessary in the interests of price stability." Similarly Keynes, who in 1913 blessed the sterling exchange standard and was thus partly responsible for its almost indefinite perpetuation, could still congratulate the Indian currency authorities that they had kept the Indian price structure so secure and immune from outside disturbances during the post-War years. It is a strange virtue, indeed, discovered in exchange manipulation by a pegged ratio, that it *sometimes* kept prices steady; but it ill becomes the protagonists of the 18*d.* ratio to persist in its support even when prices fell and continued to fall from 1924 onwards, if they would also thus flirt with the notion of price stability.

THE COSTS-PRICES EQUILIBRIUM

But there is yet another criterion available for determining whether the ratio was the right one or not. That is the criterion of the relationship between prices and costs. Sometimes, in the classical

style, "wages" are substituted for costs here, but although wages are a preponderant element in most costs, we must pay attention to other fixed and contractual costs, such as (in the case of the Indian agriculturist who is often his own workman), interest on past commitments, rent or land revenue, irrigation rates, etc. These elements of costs which constitute the *outgoings* of the producer have to be balanced against the prices (*i.e.*, incomings) obtained. During the currency controversies of 1924-27, no proof was brought forward to show that either wages or any of these costs had fallen in the same proportion as prices, although that august body of wage-earners, the Madras Government, wept tears of blood over the possible contingency (in the event of a 16*d.* ratio) of a future fall in real wages, without so much as pausing to think what the real wages had actually come to be like between 1922 and 1927, when what they meant to say really was that the sterling value of the fat salaries of the *burra sahibs* would come to be less! Yet, this indeed has been the gravamen of the case against the 18*d.* ratio that, while the costs (which are, in India, of an intermediate duration, without any reference to, say, a ratio of 2*s.* which prevailed before 1873), were attuned to a 16*d.* ratio and further aggravated by an upward tendency during the War years, the prices have been sagging disastrously since 1924. The rigidity of the wage

and costs structure which was responsible for the *debâcle* which, *e.g.*, followed the return to gold of England in 1925, was also a potent factor in bringing about a long-drawn depression in India which really commenced in 1922.

In the next Chapter, we shall examine, among other things, how far there has been any alignment or disruption of costs and prices; here it may be reiterated that mere price stability is to-day a discarded ideal. When the level of costs has remained high and dry, a so-called price stability at a lower level than costs must lead to a headlong disequilibrium. Thus those who have been patting the Government on the back for having achieved a stability of wholesale prices roundabout 90 and 110 between 1934 and 1938 forget that this stability is accompanied by a great and persistent disparity between prices and costs, whether in the industrial or agricultural sphere, and that the widespread unemployment and indebtedness in the country are the consequences of that disparity. The price-level in India has been shouting for a rise; but so long as the depressing influence of an inflated ratio is operative, it is futile to expect that this would come about. The effect of the ratio on the price and production structures has been like that of a slow poison causing low blood pressure rather than a complete annihilation of tissues in the body economic of India.

CHAPTER THREE

THE BUDGETARY PROBLEM

LET us now come to the factual position in India and in the rest of the world. In the previous Chapters, I dealt with the theoretical aspects of devaluation; we shall now briefly notice how different countries have fared under different monetary therapeutics. I think, by now, we should generally agree that a lie direct has been given by recent monetary history of the world to the fears and doubts of the Deflationists; anyone who doubts this should peruse from end to end the *Monetary Review* of the League of Nations for recent years. Thus, the one for 1935-36, after making a careful survey of the entire field of the world's monetary developments, declares that "It must

be recorded, as a matter of historical fact, that in those few countries which did not either depreciate their currency or use the protection afforded by exchange control to pursue an expansionist monetary policy, no considerable measure of economic improvement had taken place by the end of 1925." But if further facts are necessary as reminders, I shall recount them briefly here.

DEFLATION OR INFLATION?

The classical examples of the failure of deflationist policies are (*a*) England between 1925 and 1931, and (*b*) the gold bloc between 1931 and 1936. The events in both are too well-known to need recapitulation here. On other hand, the success of reflationist policies is illustrated in varying degrees by (*a*) the sterling area including particularly South Africa, Australia, New Zealand, Sweden, Denmark and Norway, (*b*) Japan, (*c*) United States, and (*d*) France since 1937. I will not waste space in giving the details of recovery in each of these countries but would direct attention particularly to the cases of Japan and Australia, both of whom depreciated their currencies in such wise that they could keep intact their respective price and production structures and effect a solution of the cyclical problem almost overnight. The yen was reduced in its gold value by nearly 65 per cent between 1930 and 1935, while the

Australian pound was first depreciated in terms of sterling by 20 per cent in 1931; and, when sterling went off gold, it received a further dose of depreciation in September 1931. Australia, on the verge of bankruptcy, recovered her position by a method which was pooh-poohed by the monetary prigs and "sound" financiers all over the world. In view of all these things, it is a surprise that there should still linger amongst us a school of thought which would insist upon *laissez-faire* and *status quo*. Such people are generally afflicted by an inflation-phobia; but it is not clear to them that the one thing that the recent world events have taught us is how to distinguish between a hyper-inflation (of the post-War German type) and a *corrective* reflation.

THE POSITION IN INDIA

Now what is the position in India? In India, as has been already said, currency affairs have, from the beginning, been dominated by the famous "triple interests," *viz.*, British producers and importers, the Government of India's budget-makers, and British officials in India. The conflict between these interests and India is perennial and can never be easily resolved. We all know that the staunchest supporters of the 18*d.* ratio were amongst official circles whose pockets would have been touched by a reduction. Yet, it must

be remembered that the salary scales for the Civil, Military and Medical Services were fixed on the 16*d.* basis; and, all these years since 1914 (with a short break), these services have been enjoying a windfall which has been further extended by the stupendous rise in the real value of incomes caused by the fall of prices. The Indian wage-earners and salaried servants have also gained as consumers; but unemployment has hit these people, not the British officials whose tenures have been as secure as the Rock of Gibraltar during the years of retrenchment. No one, therefore, need feel any sympathy for the British officials, if the ratio is reduced. As regards the British importers, again, the same reasoning generally holds good; the higher ratio after the war has acted like a special bounty on all imports. There is no doubt that, for some time at least, as a result of devaluation, British import trade will suffer, though it may revive later owing to increased economic activity and rising incomes in India. In the circumstances, we might even bargain for, say, a 20 per cent preference on all British imports for, say, a 20 per cent, depreciation of the rupee, if it came to that. We might still be gainers.

THE BUDGETARY PROBLEM

The budgetary issue, however, is nothing but a meaningless bogey. In the first place, why

should we worry about the budgetary balance of the Government of India *only*? There are Provincial budgets also to be considered; and there are hundreds of thousands of private and commercial budgets, not to speak of the budgets of the various Railway Companies, port trusts and other governmental and semi-governmental commercial undertakings. What if all these budgets are in deficits while only the Central budget is balanced? Yet this obviously is what is happening since 1926-27.

The figures in Table II give the surpluses (+) and deficits (—) in crores of rupees. The Central receipts and charges (in crores) for the same years were as under :—

Receipts	87	91	89	86	82	83	85	77	74	80	73	76	76
Charges	85	86	85	86	82	83	86	88	85	79	76	76	75

It will be seen that, as from the crucial years of 1926-27, generally budgetary balance was upset both at the Centre and in the Provinces, but more in the latter. If we go into figures of national income as a whole for these years, a very difficult task statistically, we shall find that national income has fallen disastrously during these years; *i.e.*, while the Central budget has been more or less balanced, the Nation's budget has been shaken to its foundations. Thus, those who sing the praises of the Government of India for having

TABLE II

PROVINCIAL SURPLUSES AND DEFICITS

(IN CRORES OF RS.)

	Madras	Bombay	Bengal	U. P.	C. P.	Assam	Punjab	B. & O.	Total
1923-24	+3.34	+.86	+.36	+2.24	+.45	+.35	+2.86	+.44	+4.90
1924-25	+3.19	+.83	+.58	+1.97	+.59	+.46	+3.08	+.23	+10.92
1925-26	+3.19	−.57	+.40	+1.52	+.16	+.27	+2.72	+.24	+7.93
1926-27	+2.66	−.37	−.20	+1.55	−.55	+.15	+.24	−.32	+2.06
1927-28	+2.00	−.29	−.04	+1.12	+.02	+.18	+.20	−.15	+2.02
1928-29	+1.40	−.34	+.08	+.83	−.20	+.01	−.46	−.08	−.42
1929-30	+1.24	+.11	+.02	+.65	−.14	−.26	−.03	−.14	+1.53
1930-31	−1.06	−1.81	−.74	−.91	−.44	−.29	−.42	−.79	−7.46
1931-32	+.05	−.47	−1.99	−.60	−.38	−.07	−.42	−.23	−4.21
1932-33	+.77	+.27	−1.29	+.16	+.01	−.17	+.17	+.05	−.03
1933-34	+.07	+.17	−1.76	−.03	−.39	−.36	−.63	−.30	−3.23
1934-35	+.04	−.26	−.06	−.13	+.02	+.01	+.66	+.06	+.34
1935-36	−.32	−.23	−.04	+.17	+.05	..	+.07	−.07	−.37
1936-37	..	+.40	−.41	−.64	−.08	..	+.02	−.11	−.82

kept the budgetary ship on an even keel and India's neck high above water by raising her credit in the world's money markets, forget that this has been done at the cost of the following things : (*a*) ruthless retrenchment and reduction of incomes and of welfare expenditure, (*b*) widespread unemployment, (*c*) shrinking Provincial budgets and cumulative deficits, (*d*) industrial and agricultural losses and growing rural indebtedness, (*e*) general bankruptcy of the railways, port trusts and co-operative societies and (*f*) growing poverty and destitution throughout the land. Thus while the people are suffering, the Government have rolled in wealth ! Budgetary balance indeed ! A system of public finance, which was never acquainted with modern socio-economic welfare activites and with nation-building services, can always enjoy surpluses, provided the trimming is well done and the extortions are kept sufficiently high.

But, apart from this hand-to-mouth aspect of budgeting, I am not convinced that, by reduction of the ratio or by delinking of the rupee from sterling, there would be either a general collapse of Indian credit or the catastrophe of a deficit. The true secret of the so-called "credit" of the India Government has been the export of gold, with which I shall deal separately in another Chapter. So long as the gold exports continued in enormous quantities, everything went on merrily,

but the real test of the Government's vaunted credit will be had in the not very distant future, when they have exhausted the accumulated sterling balances in maintaining an impossible ratio. It is a narrow view of the matter, however, which regards budgetary equilibrium as the touchstone of economic prosperity; and, in days when national Governments all over the world are actually favouring *unbalanced* budgets for rehabilitating economic activity, it is our singular misfortune that we have a Government here which is so self-satisfied and self-righteous that it is prepared to sacrifice the larger ends of national prosperity for the sake of what is comparatively a two-penny affair, *viz.*, a loss of a few crores on the budget. It is not realised, however, by these financial pundits of Simla and Whitehall that a Governmental budget is only a reflex of the economic activity in the country and ultimately derives itself from profits and incomes within the country. To my mind, there is no doubt whatever that, in the event of devaluation, there is bound to be such an enormous increase in internal economic activity that the revenue accounts are bound to show bumper returns. Here is a very interesting case in illustration, that of New Zealand. As pointed out by a leading economist of that country, Mr. A. H. Tocker: "The effect of the depreciated exchange has been to raise export receipts in terms of New

Zealand currency. For the latest year export values are about £NZ 50 m. At par of exchange with sterling they would have been £NZ 40 m. The direct result is, therefore, to increase receipts from overseas, to expand the national income and the spending power of the people, to promote more active business, to maintain all security values and to augment taxable capacity. The only important money cost to the budget is the exchange premium on the debt service overseas which amounts to about £NZ 1.75 m. on annual payment approximating £7 m. sterling. On the other hand, the increase of £NZ 10 m. in export receipts circulates throughout the country, stimulates all other industries, and tends to be more than doubled in its effect upon the national income. The gain in revenue from taxation, which ranges from 20 to 25 per cent of the national income, tends, therefore, to much greater than the cost of the exchange premium to the Budget." (*Economic Record,* March 1935, p. 90).

Thus, if devaluation is effected, while there will be an exchange premium on our Central Budget necessitating an additional revenue of Rs. 4 to 5 crores on account of the home charges, the total revenue from customs and other taxes and commercial undertakings (such as railways, posts and telegraphs, etc.) will increase to a far greater extent than this additional responsibility.

Moreover, the Provincial budgets and hundreds of other public, semi-public and private budgets will have bumper surpluses which will not have any "home charges" to pay, and which must be entered on the credit side of the national ledger. The improved chances of profits attendant upon rising price levels, with a rehabilitated equilibrium between them and the producer's costs, will certainly lead to increased employment, production and trade. It must be remembered, moreover, that the payment of home charges has been quite an ancient affair; and, before the war, we could pay out home charges as efficiently and expediently with a ratio of 16*d.* as we can to-day with one of 18*d.* *It is a fallacy, moreover, that by saving a few crores of rupees on the budget, a country can be better off in real goods*. The home charges, which are valued at about £30 m. annually, are to be paid *in terms of sterling*; and the real value of £30 m. is not in any case, determined by what ratio you choose but by the sterling price-level over which the Government of India have absolutely no control. Ultimately it is out of a favourable balance of trade that the home charges will be paid, whatever be the budget conveniences or inconveniences; and a high exchange parity is far from helpful to a favourable balance of trade. Thus the gain or loss on budget account caused by a high or low ratio is nothing but an illusion; and, in fact,

the truth of the matter is that such gain or loss is merely on paper, a purely administrative consideration involving some dexterity in the manipulation of taxation and expenditure. It is most certainly not a fundamental consideration in judging of the prosperity of a nation, which can only be gauged by such barometers as internal and external trade, total national income, employment, the degree of inequality of distribution and so on. Thus, those who are sacrificing these major quantities for the avoidance of a supposed "loss" on budget account are fit only to be the Finance Ministers of Follypore.

However, there is an important aspect of this budgetary question which is ignored in current discussions. Even if a high ratio, such as 18*d*., saved a couple of crores on the Government's budget, the maintenance of the ratio still costs the Reserve Bank, or whoever is the monetary authority, a correspondingly higher annual expenditure of sterling balances possibly entailing even a loan programme at times. Thus, the burden is shifted on from the shoulders of the Government to those of the Reserve Bank. On the other hand, if devaluation is brought about, while the Government may be on the wrong side for a couple of crores, the Bank is relieved and may find itself in possession of large quantities of sterling immediately. Thus, as a net position, there cannot be any loss to the authorities,

viz., the Government and the Bank, but possibly some gain, owing to devaluation.

A BUDGET EQUALISATION ACCOUNT

If, on the other hand, delinking is the objective (and, to my mind, there is an even better case for delinking than for devaluation of the rupee), and fluctuating exchanges within fairly wide (but not too wide) limits is the method of monetary management, the problem of budgetary balance is not more difficult either. Unfortunately, not only the Government but most monetary writers in India have exaggerated the repercussions of fluctuating exchanges upon the Indian budget. The difficulties can be tided over by the simple device of pooling the risks of *plus* and *minus* fluctuations into a Budget Equalisation Fund (a proposal made by me four years ago in the *Twentieth Century*, October 1934, Inaugural Number). Thus, when the exchange, say, rises above a focal point, previously determined or chosen (of, let us say, 15*d.*), the gain accruing to the budget in the transfer of funds on account of home charges should be credited to this Fund, while a loss due to a fall of the exchange below the focal point should be debited against it. The only practical question of importance to decide will be as regards the choice of a suitable focal point for this purpose. For the rest, the management of the exchange

itself, within the limits selected, should be by the now well-known device of an Exchange Equalisation fund, in the technique of which India, with her gold and paper currency reserves, has been the pioneer.

I hope I have answered in this and the previous Chapter the absurd argument that "the fact that India is a debtor country finally clinches the case against any lowering of the ratio," which is a common argument in the armoury of the Government's supporters who choose to shut their eyes to inconvenient facts and live the life of lotus-eaters. Indeed, it can be confidently asserted that if the Government had devalued the rupee in 1931, and corrected the topsy-turvydom of the balance of payments, we would have been in a position to wipe out the entire public foreign debt by utilising the gold exports *for that purpose alone*. The total exports of gold to this date have been in the neighbourhood of Rs. 318 crores. I believe in the event of devaluation in 1931, as will be argued in Chapter Seven, this figure would have been much higher than this. Our total foreign debt on Government account stands at the level of £360 m., *i.e.*, Rs 480 crores. If the balance on gold account (which would have been far greater than Rs. 318 crores) were made available wholly for capital purposes, we might have been in a position to cancel our entire sterling debt, or invest the

funds in corresponding sterling securities, which is virtually the same thing. This, moreover, would have, once for all, removed the supposed budgetary obstacle in the way of a more scientific management of the rupee. As a matter of fact, as we shall presently see, our enormous gold exports have been frittered away in the satisfaction of home charges and other current requirements, and even the limited sterling balances accumulated in London are now being frivolously dissipated in maintaining an untenable ratio, which has worked so much to the detriment of our economy. But, in the meanwhile, we might well ask if this is not reckless prodigality for even the financial satraps of Simla with their much-vaunted international credit !

CHAPTER FOUR

THE RATIO AND THE BALANCE OF PAYMENTS

LET us now examine the Balance of Payments of India during the last 15 years or so and consider how far the ratio of 18*d*. has been justified by the movements of the different series. It will be seen from the figures in Table III,—and it is not a mere coincidence, because we have already decided that theoretically a positive statistical result is more worthy of consideration than a negative one here,—that the years 1925-26 mark the turning point for a progressive disequilibrium of our foreign balance of payments, indicating an adverse capital account, during 1925-31, with heavy gold exports during 1931-36, only a part of which was employed in foreign investments.

TABLE III

NET BALANCES IN EACH SERIES OF TRANSACTIONS

(IN CRORES OF RS.)

	Income Account					Capital Account		
	Merchandise	Interest, etc.	Other Services	Gold	Total	Long-term	Short-term*	Total
1923-24	+110.5	−32.4	−43.3	−29.2	+5.7	+22.1	−27.8	−5.7
1924-25	+117.7	−31.8	−33.4	−73.9	−21.4	−12.3	+33.6	+21.4
1925-26	+119.1	−29.0	−36.5	−34.9	+18.7	−16.5	−2.2	−18.7
1926-27	+35.1	−29.8	−34.7	−19.4	−48.8	+38.4	+10.4	+48.8
1927-28	+51.3	−31.4	−34.7	−18.1	−32.9	+14.7	+18.2	+32.9
1928-29	+66.5	−32.5	−31.2	−21.2	−18.4	+0.5	+17.9	+18.4
1929-30	+53.8	−31.6	−18.0	−14.2	−10.0	+13.3	−3.3	+10.0
1930-31	+37.1	−33.6	−15.9	−12.8	−25.1	+43.2	−18.1	+25.1
1931-32	+22.2	−34.8	−17.9	+58.0	+27.5	+11.8	−39.3	−27.5
1932-33	−5.5	−34.4	−16.1	+65.5	+9.5	−6.5	−3.0	−9.5
1933-34	+27.1	−33.9	−12.2	+57.0	+38.0	−21.5	−16.5	−38.0
1934-35	+11.3	−32.5	−13.9	+52.5	+17.4	−8.7	−8.7	−17.4
1935-36	+19.4	−32.0	−16.0	+37.4	+8.7	..	..	−8.7
1936-37	+56.7	−32.4	−18.3	+27.8	+33.9	..	..	−33.9
1937-38	+43.0†	−32.4**	−18.3**	+16.3	+8.9	..	..	−8.9

*This item includes unknown capital items and possible errors and omissions in the income account.

†Estimated. **Assumed that previous year's figures would continue.

It must be stressed here that the net balances in the various series are more significant than the absolute figures. Thus, under a common influence, both the import and export trade might increase or decrease, but the *dynamics* of imports (which need not necessarily rise faster) might be affected in one way and that of exports (which need not fall) in another by an artificially high exchange. That is to say, in so far as the action of a high ratio is divergent upon the two series, the effects can be best weeded out from the general effects of common factors (such as the Ottawa Agreement, for example), if we concentrate on the *net* balances. In Table III, the falling merchandise balance from 1926-27 onwards, the heavy national borrowing between 1926-31, and the gold exports between 1931-38 are outstanding and significant events. (These are shown in brackets.)

The figures are based upon the League of Nations' *Balances of Payments*, 1936, in which the statements for the estimated balance of payments for India for various years were supplied by the Government of India itself. There are alternative figures supplied by the Controller of Currency, and, now, by the Reserve Bank of India, in their Reports; however, these latter are necessarily lop-sided as important series in the balance are left unestimated. It has been pointed out by some that the League figures contain a large margin

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of error and are, therefore, unreliable. This criticism, however, is incorrect. In the income account in Table III, there are four items, Merchandise, Interest etc., Other Services and Gold. Now of these two, *viz.*, Merchandise and Gold, leave no doubt as to authenticity. As regards Interest etc., this is admittedly a very steady item from year to year, as has also been recognised by the Government itself. The only item worth considering in regard to possible error is that of Other Services (*i.e.*, banking, shipping, insurance etc.). I think it will be easily agreed that the steady fall of the negative balance on this account is adequately, perhaps more than adequately, estimated in the figures given. In any case even if there be a slight error, it will be, therefore, on the right side for our argument; moreover, it cannot be a cumulative but only a *constant* error. This means that the income account is substantially correct; and if this is correct, the final result as regards the capital account (shown in the last column) must also be correct. It is in this that we are mainly interested and not in the distribution of the capital account between long-term and short-term loans.

THE RAKE'S PROGRESS

The figures prove beyond doubt that since the crucial period, 1926-27, the disruption in the balance of payments suddenly began, and the

merchandise balance began to be insufficient to pay for interest etc., other services and gold; and, in fact, right up to 1931, our gold imports had to be financed out of huge foreign borrowings between 1926 and 1931. In 1931, and since then, there has been no material change in the condition of the merchandise net balance, but the rupee has had the adventitious aid of the enormous gold exports which have been suffered to take place. The general devaluation of the sterling area in terms of gold, which has been accompanied by world-wide devaluation of several other currencies, gave India no advantage so far as her export trade was concerned; but it put a premium on her gold of about 66 per cent. It was this premium which brought about our gold exports and it is the gold exports which have supported the 18*d*. ratio between 1931 and 1938, *i.e.*, in other words, paid for the interest and other charges on income account and also put the Secretary of State in possession of sterling balances in London. It will be seen that the last twelve years' history of the balance of payments tells only the story—the sad and miserable story—of the reckless dissipation of India's capital resources to the tune of Rs.184 crores (gold), Rs. 131 crores being employed in sterling accumulation, and of the still more reckless piling up of fresh sterling debt of Rs. 135.2 crores, all this in the holy name of ratio maintenance! Rs. 319.2

crores on the wrong side of the capital account, in such a short period, is a record of national bankruptcy indeed!

It may, however, be contended that it was really the world depression which caused this *débâcle*. To this, the answer is twofold. In the first place, it must be remembered that the depression set in in the year 1929-30, while our merchandise balance and the balance of indebtedness began to be on the wrong side right from 1926-27. This can only be attributed to the adverse effects of the 18*d*. ratio. The position was undoubtedly made *more* serious by the depression later on. Secondly, there is no doubt whatever that if the Government had pursued a saner exchange policy and adjusted the ratio to the new situation thus created (as Australia and several other countries did), they would have been able to insulate and protect the Indian economy and to save us from this virtual bankruptcy on our international account. However, the Government allowed their vision to be warped by the peculiar notions that a pegged exchange was the last word in monetary management and that the Central Budget must be left undisturbed!

CHAPTER FIVE

PRICES AND COSTS

IN the previous Chapter, we examined the balances of payments and saw how the combination of a high ratio and a headlong deflation, caused by the Slump, brought about a disruption of India's external equilibrium. Even after 1931, the balances showed scarcely any improvement at all, in spite of the rupee going off gold. It will be seen presently that, not only externally but internally also, India failed to share in the increasing measure of recovery, which was the feature of international trade and of the world economic developments, as a whole, during 1932-37. The causes of this state of affairs are not far to seek; the depressing effects of an unduly high ratio upon the prices, both absolutely

and in relation to costs, led to the emergence of business and agricultural losses since 1926 onwards, but, in a sense, as the *de facto* ratio ruled since 1924 and as the currency authorities played fast and loose with the circulation with a view to its contraction even earlier than 1924, we should be looking for the consequences of the Government's deflationist policy as from 1922 or 1923.

THE COURSE OF INDIAN PRICES

We shall, therefore, investigate the movements of prices in India and other countries, including both sterling-area and other countries from 1922 onwards. The figures in Table IV which are collected from various sources show the movement of wholesale prices series in seven typical countries. The wholesale price level, being an international index proper to the several currencies, is the best index of the behaviour of the exchanges. The Casselian doctrine of purchasing power parity has been reduced to the *reductio ad absurdum*, that only prices of trade goods, *i.e.*, international prices, reflect exchange parities to any considerable extent, while such internal indices as cost of living, etc., have no real connection with the parities, although that has been the original position of Cassel. It is now widely admitted that, although interpreted in that sense, the Casselian theory becomes a mere truism, it is the only correct proposition in the

connection, (as Keynes has shown in his *Treatise on Money*, Vol. I). However, the truism is preferable to any fallacy suggested by an illegitimate alternative.

From the figures on p. 46 (Table IV), it will be seen that India has been in the throes of a long-drawn Depression since 1922, with growing unemployment and indebtedness everywhere. Even while the prices were rising in the U. K. and U. S. A. during the quasi-boom of 1923-25, the Indian price level was being forced down by a contractionist policy, and the Indian structure of production could not get any respite after the crash of 1921, unlike the European countries. It is beside the point to be told that prior to 1873 the exchange was 2*s*. gold and that, therefore, the rupee was overvalued throughout the War and post-War periods, because our costs belong to an "intermediate" period which would make 1913 or 1922 a more significant date for comparison. It will be seen that right up to 1925 the *dynamics* of the U. K. wholesale index was positive, as also of the U. S. A. index; only the Indian price level was sagging since 1923, which clearly indicates that the systematic efforts of the Government to establish the 18*d*. ratio had begun to tell upon the Indian price structure. In 1925, England returned to gold at a high parity and her prices began to sag too. From that year also, the rupee prices kept company with ster-

TABLE IV

COMPARATIVE PRICES

	1922	'23	'24	'25	'26	'27	'28	'29	'30	'31	'32	'33	'34	'35	'36	'37
U. K. (*a*) ..	159	160	173	177	157	146	144	127	119	104	86	89	90	94	100	113
U. S.A. (*b*) ..	138	156	151	160	156	147	138	136	123	104	93	94	107	114	115	124
India (*c*) ..	175	175	170	165	159	146	145	141	117	96	91	87	89	91	91	103
U. K. (*d*) ..	..	..	..	..	..	..	..	..	154	114	118	113	123	126	140	163
Australia(*e*) ..	..	..	..	..	..	..	..	165	146	131	129	129	135	135	146	..
Sweden (*f*) ..	..	..	..	..	..	..	..	140	122	111	109	107	112	116	120	137
Japan (*g*) ..	..	..	..	..	..	..	..	166	136	115	121	135	134	140	149	171
France (*h*) ..	..	..	..	..	..	..	..	100	88	80	68	63	60	54	65	93

(*a*) Economist, 1913; (*b*) U. S. Bureau of Labour, 1913; (*c*) Calcutta, 1914; (*d*) Economist, Sept. 1931; (*e*) Commonwealth Bureau, 1913; (*f*) Swedish Board of Trade, 1913; (*g*) Mitsubishi, 1913; (*h*) Statistique générale, 1929.

ling prices in their precipitate fall. The rupee thus received a double dose of deflation from 1925 onwards. In 1929 began another steep fall of rupee prices caused by an untenable ratio, which, owing to a falling balance of merchandise trade, began to exert a continuous, downward pressure on the prices. Our going off gold in 1931 along with sterling provided a little relief, no doubt; but, here again, although the English price level rose by 14 points between 1932 and 1936, the Indian price level was practically steady at 91 till 1937. A better comparison is afforded by the U. K. *Economist* "primary products" index (1931=100) for which earlier figures are not available. This index, which is more comparable with a wholesale index of a primary kind like ours, shows a steep rise from 100 in 1931 to 172 in 1936. But our ratio has acted like a continuous drag upon the rupee prices. If further proof were needed that the rupee is enormously overvalued to-day (whether or not it was overvalued in 1926-27), it is to be found in these figures, as well as in the figures for Australia, Sweden, Japan and France (*even* France).

PRICES AND COSTS IN INDIA

A comparison between the price levels of different countries is no doubt instructive, as it provides a practical proof of the proposition that the rupee ratio was stabilised at 18*d.* and main-

tained at that unnatural level without paying any regard to international price relationship. But it might be maintained that as exchange stability is inconsistent with price stability or any price policy as such, perhaps, if, say, the rupee prices were adjusted to the rupee costs, it can still be possible to exculpate the 18*d*. ratio. Towards this end, comparisons have recently been instituted by Professor J. C. Sinha of the Calcutta University (Cf. his *Indian Currency Problems of the Last Decade*). Unfortunately Professor Sinha adopts Sir Henry Strakosch's rather illegitimate theory that "the cost of living index is a good index of the cost of production in a country," and, on the basis of that theory, proceeds to show, by juxtaposition of the Bombay cost of living index with the Calcutta wholesale index, that there has been a material adjustment between the two. In a letter to the London *Economist* (20th July, 1935), as also in my own *Theory of Monetary Policy*, I have entered a caveat against this practice as having neither the warrant of theory nor the support of facts. It is true that even in Western countries satisfactory indices of costs of production are not available. Mr. Colin Clark, in his *National Income* 1924-31 and in his later extension of that work, was the first to attempt anything in that direction. In India, for the determination of the costs of production series, we have primarily to consider the agriculturist's costs and

secondarily the costs of the manufacturer. The costs may, again, be considered from two important viewpoints: (1) In the first place, *crude* costs, *i.e.*, wages, rent, interest, etc., may be taken as a whole without regard to efficiency, or better still costs *per unit* may be considered, *i.e.*, after making allowance for changes in efficiency. However, in India we might ignore changes in efficiency, as these are not likely to be very significant especially in agriculture. (2) Secondly, we might either take the *all-in* costs per unit, or only the *out-goings* of the producer. In India, the agriculturist's out-goings are land revenue or rent, irrigation rates, interest on past indebtedness, seed, manure, bullock charges, etc., while his in-comings are represented by the prices he obtains for his products. Thus, his net income covers his own wages, generally, and his normal profit. It is obvious that, as the principal out-goings such as land revenue or rent and other items such as interest, irrigation rates, etc., are rigid and contractual, if prices fall steeply, as they have done during the last twenty years, *they are bound to swallow up the margin of wages and normal profits, and even eat into the out-goings, leading to default of payments of revenue, interest and principal, and, in nine cases out of ten, involving the producer in further debt or causing him to dissipate all the available assets such as gold, cattle and land. This is exactly what has happened in India during*

the last so many years, owing to a disruption of the balance between costs and prices.

For these reasons, (and I do not wish to enter here into a detailed criticism of Sir Henry Strakosch's questionable hypothesis that cost of living reflects cost of production with a fair degree of accuracy), I feel that, far from the cost of living (of an industrial labour population of a single town like Bombay) reflecting the rural and national costs of production, even a comparison of the movement of wage series with that of prices might not be very helpful in the Indian case, in which, to a large extent, the producer himself is the wage-earner. There is strong reason to believe that the costs, *i.e.*, in this case the out-goings, of the agriculturist are far more rigid than the wage movements might indicate; while the wage series themselves, as will be shown in a minute, have in fact, been more rigid than both cost of living and wholesale prices.

In Table V, three typical series for wages, prices and cost of living are juxtaposed for comparison. It will be seen that, whether we take the years 1926 and 1927, the years of *de jure* stabilisation, when the fate of the rupee was officially sealed, or subsequent years of depression, the figures for wages and prices tell the same sad tale of a complete lack of relationship between the two. Wage costs have remained high and dry all along the line. In placing implicit reliance upon the

TABLE V

WAGES, PRICES AND COST OF LIVING IN INDIA

	1913	1926	1927	1929	1930	1931	1932	1933	1934	1935
*Wages**										
Field Labourers ..	100	194	176	180	169	138	130	127	122	112
Ordy. Labourers ..	100	181	176	180	170	143	134	127	122	117
Skilled Labourers ..	100	215	206	211	203	170	163	160	160	150
Prices										
Wholesale (Calcutta)	100	148	148	141	116	96	91	87	89	91
Cost of Living										
(Bombay) ..	100	154	152	149	137	116	109	103	97	101

*From *Report on Enquiry into Agricultural Wages in Bombay Presidency*, 1924; *Bombay in 1927-28*; and the Bombay Labour Office Index of Moffusil Wages. (What has happened in Bombay has generally also happened elsewhere; hence the figures have general significance.)

thoroughly immaterial fact that in 1926, wholesale prices in U. K., U. S. A., and India stood roughly at the same figure (about 160), and successfully misguiding himself and others into believing that *this* was the parity worth considering, Sir Basil Blackett performed the same disservice to India that his *confrère*, Mr. Churchill in England, did to his own country in imposing the Gold Standard Act of 1925 on it, in the belief that prices and costs were adjusted. India has, more or less, been suffering from the same bitter consequences of a reckless and unnatural stabilisation of the exchange, as England between 1925 and 1931.

It is worthy of note, however, that even if we compare, for argument's sake, the cost of living indices and wholesale prices, in order to establish a parity between the producer's costs and the producer's prices, still there is little proof available to show that there has been anything like parity between them during 1926-27 or later. I can understand Professor Sinha's inability to get very reliable data for costs of production; for, the statistical material itself is insufficient. But it would be far wiser to base one's conclusions on what material for costs does exist, than to adopt a questionable theory which again is thoroughly inapplicable to Indian conditions (owing to our peculiar cost structures), and to make use of an index (of cost of living) which is itself open to serious objections

on precisely the same grounds which are urged against the wage indices. Moreover, what is true of the wage-costs is ten times as correct of the true costs or out-goings of the Indian producer, because these are quite demonstrably rigid. It must be realised that as a result of the contractionist effects of the ratio, which failed even to remain neutral, not to say that it failed to provide a corrective to the repercussions of the Slump, the real burden of the rural debt has increased enormously; and the "dead hand" of usury has been freezing the producer to penury and starvation.

THE PROPER IDEAL

Recent monetary theory has outgrown the idea of orthodox finance that in currency management all that matters is exchange stability. Keynes and other leading monetary economists of the world have emphasised the fact that exchange stability is at best only an improvised *pis aller*. There is no country in the world, England, Germany, Japan and other trading nations included, whose internal trade is not of far greater importance than its external trade. In the case of India, we should realise, if we have not done so, that our internal trade is even at present several times more voluminous than our external trade; not only that, but, in the event of a real drive for prosperity being made, the future potentialities of internal pro-

duction are still more vastly significant than our future foreign trade. Under the circumstances, to stick to a pegged exchange for the sake of a smaller quantity and to use the very uncouth and dangerous lever of exchange policy to manipulate the enormous quantities of internal prices and production may be not only irrational but positively harmful. It is for this reason, that we should advocate an *independent* rupee. But if the Government is still adamant on this point and must for its own supposed conveniences, manage the rupee with a view to exchange stability, the proper course for them is not to adopt a "one and immutable" ratio for all times to come but to *adapt that ratio periodically, say every ten years or so, to the changed conditions*, as reflected in the balance of payments, prices, employment and total production.

CHAPTER SIX

RECENT EVENTS

THERE are other and stronger arguments why the rupee should be relieved of its membership of the sterling area. Although several countries have hitched their currency waggons to the star of sterling, they have retained their freedom to vary their parities, which safeguards them from the untoward effects of any insularism in sterling policy. In spite of the fact that sterling is no longer a national, but an international currency, it is unfortunately true that the sterling authorities have given more attention to the exigencies of their own national and domestic requirements, dictated by their own foreign trade, their own balance of payments and their own exchange situations. It

is unthinkable that the requirements of all the members of the sterling area can be on all fours with those of England. Especially, a predominantly agricultural country like India cannot serve its own interests by maintaining the rupee in what may be styled a "holy deadlock" with sterling, whose affiliations are predominantly industrial. The debtor-creditor relationship also points to the same divergence of interests and objectives. To-day, sterling is dancing to the tune of the dollar, which, again, owing to the peculiar situation of the gold market, the recalcitrance of the Courts and the Constitution, the mutual contrariety of the economic policies implicit in the New Deal and its offshoots, and, lastly, the vicious circle of the steadily mounting gold stocks financed out of enormous dollar loans, is almost a derelict currency in spite of its firmness and is managed not by the "24-hour-basis" Morgenthau but by uncontrollable external forces over which America has no influence. In this currency medley, I believe, India can, to a very large extent, insulate her economy from the repercussions of international economic disequilibria by pursuing an independent monetary policy. In any case, it is a matter of supreme importance that the rupee should be free from the sterling nexus and the sterling incubus.

THE IMMEDIATE SITUATION

The immediate situation of prices, production, stock markets, balances of trade and indebtedness, and the budgets leaves no doubt in one's mind about the fact that the Government and the Reserve Bank are gradually getting into the last ditch in a losing battle to maintain the 18*d*. ratio. But they will not admit this. Aren't they the most infallible, the most impeccable Government in the world? A situation, which would have caused (as it did actually in 1931), a major political crisis in their home land, leaves the big bosses in Simla absolutely cold, solidly entrenched as they are in their Olympian seats.

What, then, is the truth about the present exchange situation? The truth, as it must appear to every dispassionate scientist, is as follows: The main buttress of the 18*d*. ratio since 1931, have been (*a*) the enormous exports of gold between 1931 and 1938 and (*b*) the slightly improved merchandise position during 1935-37 as a direct result of recovery in Europe and America (which was first sustained by the various "prosperity drives" and later by the war-mongering in Europe and the Far East). As will appear from the adjoining Table VI, till the end of the first quarter of 1937, the shrinking gold export coincided with increasing results on the merchandise account and this enabled the Government to tide over their difficulties.

TABLE VI

RECENT BALANCES OF TRADE AND TREASURE

(IN CRORES OF RS.)

	Goods			Treasure		Final
	Imports	Exports	Balance	Imports (silver)	Exports (gold)	Balance
1936						
3rd quarter ..	−28.3	+42.6	+14.3	−2.6	+19.0	+30.7
4th ,, ..	−30.0	+50.3	+20.3	−2.9	+7.1	+24.5
1937						
1st ,, ..	−32.9	+50.7	+17.8	−3.9	+4.2	+18.1
2nd ,, ..	−42.5	+50.0	+7.5	−0.9	+3.4	+10.0
3rd ,, ..	−40.2	+48.3	+8.1	−1.0	+4.9	+12.0
4th ,, ..	−43.3	+43.3	..	..	+3.9	+3.9
1938						
1st ,, ..	−41.7	+39.4	−2.3	+.2	+1.1	−1.0
2nd ,, ..	−37.9	+37.4	−0.5	−.9	+3.5	+2.1

The preceding Table (Table VI) excludes the invisible items of Interest etc., and Other Services, which from Table III given in Chapter IV, would appear to be in the neighbourhood of Rs. 32 and Rs. 18 crores respectively. Thus, for a quarter the final balance in Table VI above must make a provision of Rs. 12½ crores as a *minimum* proposition. It will be seen that from the fourth quarter of 1937 onwards, the final balance fell below this, thus showing the weakening condition of the exchange. In the first quarter of 1938, the final balance actually became negative. Until April, the Reserve Bank was able to meet Government's sterling requirements by buying sterling tendered to it each week at a rate of 1*s.* 6⅛*d.* In the middle of April, the offering of sterling at that rate ceased and since then there has been a lack of agreement between the market and the Bank as regards the sterling tender rate. The consequence has been that the Reserve Bank has now no choice, as the *Economist* puts it, but to "live on its own fat," accumulated in the last few years. A Calcutta contemporary complacently remarks: "The prudent financial policy (*sic*) of the last decade has certainly strengthened the hands of the Government of India towards meeting the difficulties to come. It has also assisted them to build up a sterling position (*sic*) in London. When this is exhausted, it should be possible for them

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to obtain ready sums of sterling through the flotation of loans there." It is indeed news that it was the "prudent" policy of the *Government* which enabled them to build up balances abroad! It is indeed a height of financial "soundness" for the champions of orthodoxy to suggest that there should be new flotation of loans to maintain an untenable ratio! Yet, in fact, the "fat" is accumulating since 1931 and not since 1926 (the year in which the "prudent" exchange policy was inaugurated) and the accumulation is wholly due to the exports of gold, which have been partly employed in meeting the current requirements and partly in accumulation of sterling balances. Nor is the "fat," thus accumulated at the expense of India's leanness, so very substantial. Table VII throws some light on the Reserve Bank's gold and sterling resources and our monetary circulation.

TABLE VII

THE RESERVE BANK'S GOLD AND STERLING RESOURCES

(IN CRORES OF RS.)

	May 28, 1937	August 12, 1938	Intervening change
Gold	44.5	44.4	— 0.1
Balances abroad ..	24.5	3.4	—21.1
Sterling securities ..	80.3	69.5	—10.8
Total ..	149.2	117.3	—32.0
Note Circulation ..	190.2	175.1	—15.1
Rupee coin circulation	..	..	—15.2
Total contraction ..	..	..	—30.3

From the above Table it will be clear that within fifteen months,* the "fat" has already melted with considerable damage to the circulation in India. Further dissipation of its resources by the Bank

* Since the above was written the position has deteriorated further. Sterling securities have fallen (January 7, 1939) to Rs. 59.5 crores, implying a further dissipation of Rs. 10 crores. Balances abroad have come down to Rs. 1.3 crores, *i.e.*, a further dissipation of Rs. 2.1 crores. The rupee coin circulation has fallen by a further amount of Rs. 3 crores. On the other hand, the active note circulation has risen to Rs. 180.2 crores, showing a net increase since August 12, 1938, of Rs. 5.1 crores. Thus, the total dissipation from May 28, 1937 to January 7, 1939 has been Rs. 44.1 crores; and the total contraction of currency during the same period has been Rs. 28.2 crores.

would lead to greater and greater contraction of rupee circulation to the detriment of trade and employment. If nothing is done about the ratio, further dissipation, however, seems inevitable. There have been enormous decreases in the last few months in the exports of raw materials, such as cotton, jute, hides and skins, wool, lac and manganese ore, which clearly indicate that our export trade has turned the corner. In view of the faltering recessions of business abroad, it seems unlikely that there will be a rebound. On the other hand, it does not seem likely that our imports will fall off so much (in spite of a hope expressed by the *Economist* to that effect) as to relieve the tension on the rupee exchange, by offsetting the fall in exports. The only way out, if it is really "a way out," seems to be for the Government to discontinue their remittance programme for the time being, in the hope that things will right themselves in due course. The hope is bound to be a forlorn one, in view of the recession of industrial activity in the West and in view of the refusal of up-country gold-hoarders to be further coaxed into parting with their gold. It is true that during the last three or four weeks the Reserve Bank has been able to buy some quantity of sterling again, and that this factor taken with the probable withdrawal of the Government's remittance demand has eased the exchange to some extent. But the "fat"

is in the fire, and we shall soon see a reversion back to difficult conditions. The sterling purchases have been facilitated by a temporary spurt of gold exports caused by the weakness of sterling in terms of the dollar which has put a temporary premium on Indian gold in the American market. The future of gold exports will depend upon what action the American authorities may be taking to deal with the rise in the dollar.

TABLE VIII

RECENT MOVEMENT OF CROSS-RATES AND GOLD PRICES

	£-$ cross rate	£-Franc rate	London Price of Gold	Bombay Price of Gold
1938				Rs. a. p.
July 27 ..	4.92	178.0	£7-1-4	35 9 9
August 3 ..	4.89	178.4	£7-2-½	35 13 9
August 10 ..	4.88	178.9	£7-2-6	35 15 3
August 15 ..	4.87	178.9	£7-2-8	36 1 6

It will be seen from Table VIII,* that the Reserve Bank's recent sterling purchases have been facilitated by the sudden spurt in gold exports caused by the dollar cross-rate and not

* On January 3, 1939, the £–$ cross rate was 4.64; the £–Franc rate was 176.7; the London price of gold, £7–10–5; and the Bombay price, Rs. 37–10–0.

by any trade demand, which has been almost at a standstill. It is, therefore, only a question of time for the rupee to plunge headlong below the statutory level; for the Government's remittance demand is bound to be very urgent in the near future.

IS IT A SEASONAL WEAKNESS ?

It is asserted by some that the present weakness of the rupee is merely a seasonal affair and when the seasonal setback is over, it will be plain sailing again. Such assertions indeed completely ignore the factual position. In Table IX, the total imports and exports of India are juxtaposed for comparison. (See *Post-script* also.) It will be seen that there is no question at all of any seasonal falling off of trade, but a continuous downward trend both for exports as well as imports, but more particularly in the case of exports.

TABLE IX

EXPORTS AND IMPORTS

(IN CRORES OF RS.)

	Total Imports			Total Exports*		
	1936-37	1937-38	1938-39	1936-37	1937-38	1938-39
April ..	10.12	15.73	13.43	15.33	17.56	12.66
May ..	10.05	14.38	12.44	14.50	16.64	12.02
June ..	9.79	13.89	11.99	13.48	17.86	12.72
July ..	10.09	14.18	..	14.46	17.38	..
August ..	9.29	13.35	..	14.22	15.27	..
September ..	9.55	13.71	..	15.19	17.10	..
October ..	10.67	14.54	..	16.61	16.23	..
November ..	10.62	15.82	..	17.42	15.13	..
December ..	9.98	14.35	..	17.88	14.01	..
January ..	12.59	15.91	..	22.07	14.41	..
February ..	9.36	12.58	..	19.05	12.80	..
March ..	13.12	15.34	..	22.11	14.79	..

Table IX makes it abundantly clear that there has been a steady deterioration in the merchandise trade which is at the bottom of the present weakness of the rupee. Where is the seasonal factor in the above Table? The exports are dwindling at a faster rate than the imports. This may be due to some extent to the time-lag between the European recession and our own. But there is no guarantee in the trend of figures that the imports would fall to an extent sufficient to provide the

margin for the Government's remittance, specially when both imports and exports become statistically small quantities. Thus the whole brunt of maintaining the rupee will fall upon the exports of gold. A suggestion has also been made in responsible quarters that speculative activity has been an important factor. This is an exaggeration. Speculation is always an incident of fluctuation in exchange in every country; but that either this or the suggested selling pressure on the rupee by interested parties could have been an instrumental cause of the present decline of the rupee is a highly preposterous proposition. When the factual position of the balance of payments is so crystal clear, must we go so far afield to seek the causes of the decline? Who is there so foolish as to invest and lock up funds in speculation especially when the monetary authorities are so self-satisfied and so dogged in their determination to maintain the rupee, against all odds, no matter whether India becomes bankrupt internationally or whether her *debouches* of production and employment are wholly destroyed?

In the foregoing pages, decisive evidence has been adduced to expose the fallacious contentions of the Government of India, (1) that the international situation is still far too unsettled for the ratio to be revised, and (2) that the resources available for the maintenance of the ratio are "more than ample." And yet, the Government

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dogmatically continue to assert that their position is the correct one, and in a recent reply to an interpellation, the Finance Member reiterated his flimsy pretexts again to stalemate the Opposition moves. Why should Sir James Grigg fight shy of a straight and open inquiry into the currency question and take shelter behind the provisions of the Government of India Act and its "safeguards" and "discretions"? We shall presently examine the statement that "maintenance of the present value of the rupee is required in the interests of India" and of the "poor agriculturists." The Government should realise that assertions are no arguments and that beliefs are no proofs. If they would have the *Indian* interests and the agriculturists (whose welfare is so dear to their hearts) to accept their *bona fides*, they should place their cards on the table and make a clean breast of it.

"The most immediate danger of the rupee's present weakness," says the *Economist*, "is that it may be a temptation to the Indian authorities to endeavour to correct it by traditional methods, involving higher interest rates or a restriction of credit at home." There is no prospect of lower interest rates yet, as the Reserve Bank has maintained a so-called "cheap money policy" of a 3 per cent rate; but if the rupee contraction (both by way of reduction of the note circulation and the return of rupee coins) continues unabated, sooner

or later there is bound to be a stringency in the money market. In any case, it is not the cheap money in the industrial cities that matters so much as the *currency circulation in the country as a whole;* for India is notoriously a country of currency circulation, and credit is a secondary affair, mostly confined to industrial finance. The headlong contraction of currency, which is implicit in the Government's programme of exhausting the sterling and other resources and in the constant reversion of rupee coin to treasuries, must, therefore, adversely affect the *agricultural* economy of rural India. The very non-vocal agricultural interests, which the Finance Member claims to represent as their *soi-disant* champion, are likely to be injured most by his stubborn and irrational policy. In view of the immense injury which the deflationist policy of the Government has done to agriculture, in particular, during the last twelve years or more, the so-called "agricultural" policy of Lord Linlithgow's Government becomes sheer tomfoolery, if not a big hoax. Even the most dispassionate student of the problem can testify to the fact that agriculture has been hit particularly hard by the collapse of prices and incomes, in which the depressing influence of the ratio has played a major part. If Sir James Grigg or his economic advisers are going to tell us that further contractionism, which is inevitable, is going to do any good to the *farmer*,

either they must be underrating our intelligence or beguiling themselves.

But, probably, the Government have in view another possibility in their reiteration of these exploded myths. It has been a pet idea of the Finance Member that devaluation might lead to a rise of prices of consumption goods, thus reducing the standard of life of the rural population. The fallacy of this idea has not yet been fully exposed. It must be pointed out that the villager consumes only a fractional proportion of the imported goods. Thus, if the prices of imports rise a little, it is not going to affect the villager to any material extent. As regards the internal consumption of goods, low prices would be helpful to consumption, if the villager had any income to spend at all. The present situation in India is best described by the well-known paradox of "poverty amidst plenty." *Consumption goods are available dirt cheap, but the people have no purchasing power*, owing to their making continuous losses as producers. The rise in prices of consumption goods is bound, by all tokens of economic laws, to take place as an aftermath of a rise in the prices of producers' goods ; while, as the costs of production are largely rigid (and very much so in the case of Indian agriculture), a partial rise in the cost of raw materials and implements is most assuredly not going to cut into the profits of the agriculturists.

CHAPTER SEVEN

THE PROBLEM OF GOLD EXPORTS

LET us now briefly analyse the causes and the consequences of the gold exports in recent years and assess their technical importance to the ratio question. This question has been thoroughly threshed out in a recent controversy in the *Indian Journal of Economics* (July 1935 and January 1936) in which I participated. I do not wish, therefore, to repeat all the arguments advanced there to correct certain popular misconceptions regarding the nature and significance of the Indian gold exports; but I shall briefly state my main conclusions regarding this phenomenon.

As regards the causation of the gold exports, it has to be admitted that the ordinary principle of

the gold standard, that gold exports are required to fill the gap created by an adverse balance of trade (to the extent that it is not corrected by the invisible account and the securities balance), is clearly inapplicable here. The Indian rupee has not been on the gold standard either directly or indirectly between 1931 and 1938, and there has been no obligation at any time on the monetary authority requiring it to sell gold for export in the event of the exchange falling below the export point. In fact, even prior to 1931, in spite of an adverse balance on the visible and invisible account, there were substantial imports of gold which were partly fed out of foreign loans. (Cf. Table III.) The adverse effects of the 18*d.* ratio prior to and after 1931 can be strictly said to be confined to a general economic *malaise*, reducing the purchasing power of the Indian masses to such an extent that their customary purchases of gold, as a form of capital, were on the down-grade up to 1931. In 1931, if anything, the departure of sterling from gold afforded a measure of devaluation to the rupee in terms of the *gold* currencies and put a premium on our gold in terms of the new exchange rates established. This departure from gold also provided a partial relief to the masses whose ability to buy gold did certainly not further deteriorate after 1931. It was, therefore, *the premium put on the value of gold exported abroad that was the most potent*

cause of our gold exports. It is not true, therefore, that the high ratio has been responsible for the gold exports, except to the extent that it has indirectly facilitated them by creating *distress* among the rural gold hoarders and by increasing their willingness to part with gold. However, if it were not for the departure of the rupee from gold, in all probability there would have been merely internal transfers of gold between the distressed agriculturists and the moneylenders. There is reason to believe that such transfers had been going on, irrespective of the question of any exports, from a fairly early date. The "distress" sellers of gold are not normally prone to selling, for they rightly regard gold as an asset to fall back on in bad times; and if it were not for their capital attenuation, the commercial sellers would not have probably been able to get such large quantities of gold for export at a profit. On the other hand, we must be thankful for little mercies that the abandonment of the gold nexus by sterling and the rupee rendered possible the liquidation of the dead capital assets in gold at a price higher than otherwise obtainable (and higher than the price available prior to 1931), and thus, *pro tanto*, increased their capital wealth and provided some little relief. There is another misconception prevalent that gold exports were necessitated by the need for maintaining the 18*d*. ratio. Since 1931

and up to 1937, however, exports of gold were so superabundant that the ratio was continuously at the upper point, the pressure being such that actually the Government were in a position to buy sterling and build up decent balances in London. Only recently, it can be truly said that gold exports have enabled the authorities to maintain the ratio, and that in their absence it would tumble down.

The correct view of the matter is, therefore, that gold is flowing out just like any other commodity in expectation of a higher profit abroad made possible by the premium. This premium mainly depends upon the sterling-dollar and sterling-franc cross-rates and fluctuates in proportion to the depreciation of sterling in terms of the currencies of the gold trade centres, such as New York, Paris and Amsterdam. London has done an enormous business during the last few years as the world's principal *entrepôt* in this connection, and the final destination of gold arrivals has not been always the same. It must be recognised, moreover, that the exports of gold from India are only a portion of the total supplies of gold which are at present being thrown on the world market, by the principal producers, *viz.*, South Africa, Australia, Russia, U. S. A. and Canada. On the other hand, the principal purchasers are U. S. A., England and France, while most European

countries have been keeping out of the gold craze. Most countries of the world have now learnt to manage their currencies without the help of gold backing. It is not likely that after their experiences of the gold standard during 1929-32, they will either have the *inclination* or feel *necessity* to adopt gold for monetary purposes. The monetary use of gold has now been reduced to the sigle function of a corrective to exchange fluctuations through the agency of exchange equalisation funds. The managers of the funds in every country, on their part, have also come to realise that exchange fluctuations can be mitigated by other and less costly means and processes (as, *e.g.*, by purchase and sale of foreign securities); and if they have not yet renounced the use of gold, it is because in the event of depreciation of gold, their own stocks of gold would become worthless. Thus, to-day U. S. A., England and France have the greatest stake in the future of gold: U. S. A., because it is the biggest holder of gold; England, because, apart from its own stocks of the metal, it has to safeguard the prosperity of three gold-producing Empire countries, South Africa, Australia and Canada; and France, because her people have an undying faith in the security of gold and also for military reasons. But the premium on gold has keyed up the supply of gold to an unhealthy extent, both owing to the profit obtainable as well as the

anxiety of gold miners to exhaust their mines (*e.g.*, in South Africa) and place their stocks on the market, while the going is good and the price of gold is high. Some few months ago, there was a gold scare, but owing to a timely announcement by the authorities concerned it was stayed. Now there is an alternate flight from gold into the dollar and *vice versa*. But there is, to my mind, not the slightest doubt that the inexorable laws of economics must sooner or later put an end to the unnatural situation, in which countries are gradually realising that the white elephants of their gold stocks are too high a price to pay for keeping down exchanges and in which the unwanted stocks of the world are being gradually unloaded and palmed off on the unwitting cornerers of the metal. Whatever be the temporary and short-run aspects of the matter, therefore, the under-current of events indubitably points to a *débâcle* of gold.

Looked at from this angle, I think, the present gold exports from India may appear to be a very desirable movement, because a poor country like ours cannot afford to allow our accumulations of gold (and silver) to freeze on our hands. India has always imported gold and silver for centuries (with one or two short breaks) and her present stocks of the metals, are such as to give cause for anxiety. It is a wrong proposal, therefore, to suggest an embargo on gold exports or an export duty or

even purchase of gold by the Reserve Bank. For one thing, any restrictions on gold exports are bound to reduce the rupee price of gold available to the "distress" sellers and to that extent harm, rather than help, them by aggravating their distress; for another, there is hardly any scope for utilisation of the gold for monetary purposes by the Reserve Bank except to a very limited extent, the present stocks being adequate and reflation being possible even without hoarding gold, *i.e.*, against the exports of gold. Gold exports, moreover, are a symptom of a deep-rooted disease which cannot be cured by stopping gold exports, but for which quite another set of remedies is likely to be helpful. The distress has been caused by the deflationism and the supinely *non-possumus* attitude of the Government in respect of their monetary, financial, tariff and public-works policies and aggravated by the depression; and it is on these charges that we must indict the Government. Secondly, as stated in previous Chapters, they are also at fault in allowing a capital asset like gold to be dissipated in the satisfaction of current requirements, *i.e.*, in causing the country to live on its capital, on its accumulated "fat," when the right course for them to follow would have been to take expansionist measures of various kind (reflation by devaluation, safeguarding of industries, a public-works programme and so forth), and, by harnessing the productive

forces and idle resources of the country, enable it to balance its current national budget of production and consumption. Instead of doing any of these things, the Government of the day unfortunately has been pursuing policies which glorify the "consumer" interests at the expense of national wealth.

The Indian gold exports, which have been largely facilitated by the willingness of distressed sellers to part with their gold, have thus played the role at once of a symptom and a safety-valve. It is a wrong therapeutics of the disease to suggest that, by stopping the gold exports, the distress will be relieved; for aught we know, the disease might even be aggravated by any restrictions on the free sale and exports of gold. On the other hand, it is wrong economics to suppose that any country can ever augment its wealth and welfare by locking up its investable resources in a barren, unproductive and intrinsically useless assest like gold (or silver). It ill becomes us to condemn our gold-hoarding habit and in the same breath condemn the gold exports as well. Sir James Grigg, in reply to a recent interpellation, said that since 1893 to 1931, India imported about Rs. 1,450 crores worth of gold. If we begin from an earlier date, say 1,800 A. D., the figures would be still higher. It cannot be too extravagant a guess that the net imports till 1931 as from that date were

not less than Rs. 2,000 crores. At the current value of gold, these will amount to Rs. 3,500 crores. Princes, zemindars, a large section of the middle-class population and commercial sellers have for generations kept their assets in the form of gold among other things. The higher strata of society are not likely to part with their gold even if the price of gold is high; it is the villager who has had to sell his trinkets to keep the wolf away from his door. If we add to our gold stocks our stocks of silver, which probably have been as important in value, we would realise what an enormous wealth we have frittered away by sterilising it in the form of a dead capital asset. *Properly invested* (and, unfortunately, it is true that the man in the street so far had no suitable avenues for investment), these enormous stocks of the precious metals would have multiplied our wealth tenfold by the operation of the compound-rate principle. Even to-day it is worth our while, therefore, to convert our gold and silver stocks into interest-bearing securities (cancelling our foreign public debt) and into durable reproductive capital (which can be the basis of our industrial prosperity). Even at this late date, it is possible to rectify our past mistakes and enable India to emerge as a leading creditor nation of the world by the mobilisation of our stocks of gold and silver.

In my opinion, there are two main ways in

which this mobilisation of our dead assets can be brought about. The first is for the Government to commandeer the available gold and silver at suitable prices, by forcing (somewhat on the lines of the corresponding British law) the hoarders to convert their gold and silver into cash certificates and securities, and then to unload the stocks gradually on the world market. The second method, which is less certain but more agreeable, would be the devaluation of the rupee. It is the belief of many that devaluation would lead to a cessation of gold exports. Such a belief is based upon the wrong analogy of a gold-standard country. If the rupee is devalued to a lower level (whether 16*d*., 15*d*. or 12*d*.), the most unmistakable consequence of this will be that there will be a greater premium than now on exported gold, with a corresponding rise in the rupee price of gold (Rs. 40, Rs. 43 and Rs. 54 per tola respectively for the above ratios). Thus even if our visible balance of merchandise trade improves, the exports of gold will increase still more, thus enabling us to cancel our foreign debts and/or to build up foreign investments. There is no reason, therefore, to develop cold feet, if, in consequence of devaluation, still greater exports of gold take place.

Thus, a dispassionate consideration of the gold problem also leads us to the same inevitable desideratum, *viz*., the devaluation of the rupee, which

is essential for correcting the balance of indebtedness and for applying the exports of dead capital (gold) to the purpose—the only legitimate—purpose of cancelling foreign debts and building up earning assets abroad. Unfortunately, the Government of India is not alive to these possibilities and the Finance Member informed the House that it was good business to sell a commodity (gold) at 70 per cent profit and to invest the proceeds in other securities. Though he was right as regards the former part of this statement, he was very wide of the mark in asserting that the proceeds were, except to a small extent, being invested *in other forms of capital*. This is no more true from the national than from the individual standpoint.

CHAPTER EIGHT

OBJECTIONS ANSWERED

THE case for devaluation being thus established beyond the shadow of a doubt, the next thing that remains to be done is to answer the various objections raised by the carping critics and the doubting Thomases.

(1) Objection No. 1 is that there is no particular sanctity about the 16*d.* ratio, which ruled prior to the War, and that the 18*d.* ratio is as good as any other. This objection is based upon a misconception of the demand of the devaluationists. It is, of course, true that the 16*d.* ratio is not so sacrosanct to-day as it could have been, say, ten years ago, in view of the enormous changes that have taken place in the structure of production and

prices. However, the 18*d.* ratio itself is no more sacrosanct than the 16*d.* one. In view of the need of rehabilitating prices, production and employment, even a ratio of 16*d.* may not be enough. Something like a 25 per cent devaluation on the Australian model may about meet the requirements of the situation. Thus even a ratio of 14*d.* or 13*d.* may be more appropriate.

(2) Then, we are told that the Indian devaluation may lead to "competitive depreciation" and our Finance Member says that he, for one, will not have "any part or lot" in the race for depreciation, or allow people to "monkey" with the exchange ratio. This holy dread must appear to be somewhat morbid. When the whole world has tasted of this forbidden fruit, nay, gorged and choked itself up with this monetary delicacy, the poor Oliver Twist of India is told that he must not ask for it, lest the appetites of the others might be again roused! It is an incorrect proposition that devaluation in India will ever set in motion a race for further competitive depreciation, when before our very eyes, France has devalued her currency at least three times, with the acquiescence of the other monetary authorities. What is India or the Rupee in the scheme of world finance, that a partial depreciation here is going to have such grave repercussions abroad? And, even supposing that the worst comes to the worst and competitive

depreciation does ensue, will this be such a calamity for the world? When a majority of the currencies are *off gold*, competitive depreciation will only mean that the relative positions of currencies will be just where they were, *i.e.*, that the *status quo* will be maintained. There is no fear of any hyper-inflation taking place in the world.

(3) But, say the critics, India has already had a substantial measure of devaluation in 1931, when the rupee, along with sterling, went off gold and fell to about 60 per cent of its previous gold partiy. This is supposed to be a strong point against devaluation. Now, in fairness it must be admitted that if it were not for the departure of the rupee along with sterling from gold in 1931, conditions would certainly have been worse than they were during 1931-38 and India would have experienced the same difficulties as the deflationist gold-standard countries did during 1931-36. But that is all that can be said. To go further and say that India in any way has *benefited* by the devaluation in 1931 is a misstatement. Devaluation is theoretically required to meet two situations in the main: a disrupted balance of payments, and a disequilibrium of prices and costs of production. If it cannot achieve either external equilibrium of foreign trade or the internal stability of trade and employment, it is as good as useless. Is there anything to show that the so-

called devaluation of 1931 achieved either of these results? In the first place, the comparative position of the rupee *vis-a-vis* the world's principal currencies was no better and became possibly worse, in spite of the departure from gold. As the accompanying Table (X) shows, almost all the currencies of the world have fallen considerably below their pre-depression gold parity.

In Table X, the countries have been arranged under four columns. Columns 1 and 2 show countries which have devalued their currencies to an even greater extent than India; column 3 shows countries which are on a par with India even after 1929; while column 4 shows countries which are on a higher parity in gold. It will be seen that the countries, with which India has trade relations of volume and importance, almost wholly fall in first (col. 1 and 2) and second (col. 3) groups. The countries in the last group (col. 4) are either very small or have adopted exchange controls and bilateralism—thus the fact that they are on a higher parity confers no *exchange* advantage on India. With regard to col. 3, the *status quo* is maintained, so that if there was any case for devaluation of the rupee in terms of these countries' currencies during 1929-38, that case has not weakened due to their devaluation. On the other hand, the great majority of countries, which have reduced the gold contents of their currencies to a far greater extent than

TABLE X

THE MEASURE OF DEVALUATION OF WORLD CURRENCIES

(GOLD PARITY IN 1929 = 100)

Column 1		Column 2		Column 3		Column 4	
China ..	41.9	Peru ..	36.3	United Kingdom ..	60.9	Austria ..	79.5
Spain ..	24.5	Mexico ..	32.9	*India* ..	*61.3*	Venezuela ..	95.7
Iran ..	41.2	Denmark ..	49.4	Brit. Malaya	61.1	Yugoslavia ..	78.5
Uruguay ..	37.3	Norway ..	55.6	Canada ..	59.1	Czechoslovakia	70.1
Argentina ..	46.5	Sweden ..	57.0	Portugal ..	60.5	Belgium ..	72.1
Brazil ..	43.3	Finland ..	52.0	Siam ..	61.4	Luxemburg ..	90.1
Bolivia ..	9.0	Japan ..	34.4	South Africa	60.3	Roumania ..	72.8
Australia ..	48.5	Costa Rica ..	42.0	United States	59.1	Netherlands ..	82.2
New Zealand ..	48.9	Greece ..	41.8	Estonia ..	61.4	Switzerland ..	71.1
Chile ..	25.1	Ecquador ..	21.3	Italy ..	59.0	Germany ..	?
Columbia ..	53.4	Danzig ..	57.6				
France ..	49.5						

India, have put India to a new disadvantage which did not exist prior to 1931. In particular, India's competitors like Japan, China, Argentina, Australia and New Zealand, largely fall in this group. How can anyone expect under these circumstances that the Indian balance of trade can receive any assistance from the level of *exchange*, whatever the other forces may be?

As regards the price level in India, it has been almost stagnant after the disastrous fall between 1921 and 1931; there has been nothing like rehabilitation of the equilibrium between costs and prices, as we have seen already in an earlier Chapter. It will have to be admitted, therefore, that the so-called devaluation of 1931 was not of any use to India at all; at the most, it might be said to have avoided a further deterioration after 1931. There was no positive benefit accompanying it, while so far as foreign balances are concerned, it definitely worsened the position. For the rest, the only positive result to its credit was the Gargantuan export of gold during 1931-38.

(4) A fourth objection is raised by some critics that reflation of prices through devaluation may not help a recovery or rehabilitation and my friend, Prof. P. J. Thomas, often quotes an old discarded dictum of Keynes that "You cannot grow fat by using a bigger belt." Thus, according to him, "Currency manipulation *i.e.*, exchange

manipulation, is no suitable means for producing a stable rise in prices. A general upward trend of prices is desirable, but such a change can come about by an increase in demand and employment. It must begin at the employment end and not at the currency end. Hence the highly beneficial results which might have come from a carefully designed public works expenditure in India after the depression had reached its bottom." Now, in the first place, it stands to reason that although we need not perhaps use a bigger belt, this is no reason why we should use one so short as would almost strangle us out of our breath! It is at least *possible* that the ratio belt might have been too tight all these years. That was precisely the complaint of Keynes against the post-War gold parity of the pound and, as far as monetary expansion is concerned, it is all in the *Treatise* and the *General Theory*, whether you like it or not. Keynes's real view is not that there is only one "public-works" end to bring about greater employment, but that there are various ends suitable for different situations severally or jointly; countries on an exchange standard might find (as in Australia and New Zealand) depreciation helpful; in others, both currency and credit expansion through note-issue and the bank-rate might be tried; in still others, public works or fiscal measures enabling expansion within a closed area might be more

expedient. Here are the various ends and possibilities—which can be tried by the Government of India as they have been tried elsewhere. But what have we here but all the orthodoxy, nihilism, pessimism and do-nothingism that we might expect fron an unenterprising, antiquated and an anachronistic Government? Professor Thomas pins his faith on public works, but in view of the low ratio of primary to secondary employment (4 : 3) which he has worked out, I doubt very much if the solution of the gigantic problem can be suitably managed by a public-works programme alone, which would have to be on a really tremendous scale to be successful. I have no objection to public works *per se*, however. On the other hand, devaluation would give an immediate relief to traders and producers by taking a load off the price and trade structures of our economy and would redress the wrong that has been done all these years by giving an all-round impetus to trade, both foreign and domestic.

(5) Fifthly, there is another objection raised by critics against devaluation and reflation, *viz.*, that the advantages are bound to be only *temporary*. This *criticism* reminds me of an American merchant in a Mark Twain novel, who on being told that "Beauty is only skin-deep" replied that it was enough for most men! Thus even supposing the advantages of these measures are really of a tem-

porary duration, I think the duration is long enough for most economic systems to avail themselves of. But it is a fallacy, in the first instance, that the advantages of depreciation *are* temporary. And, secondly, it is a mistake to suppose that depreciation is asked for in order that we should be able to reap some undeserved advantages which are not indicated by the exigencies of the situation. As I see it, depreciation is required not as a windfall but as a highly necessary corrective for all the disadvantages which have been hampering our economy of late. It is said that when prices rise all round, there would cease to be any advantage, and the merchants and producers will begin to clamour again for further doses of devaluation. But those who assert that all prices and all costs would rise in the same proportion in a kind of Marathon race do not know the A-B-C of the price mechanism. Various monetary measures would affect different price groups in various ways. It all depends upon where the money factor is first inserted. Thus, in the case of exchange devaluation, the international price level in terms of the rupee will experience an immediate rise, which would be automatic and nearly proportionate to the degree of devaluation, because the exchange rate (which is nothing but the terms on which we are prepared to buy foreign goods and sell our own) will immediately open up possibilities of a

greater demand for our goods. And discrepancy will soon be corrected by the ever-vigilant competition of international traders. As regards the domestic price level, this will be affected indirectly and to the extent to which diffusion of the initial impulse of devaluation and consequent expansion of purchasing power takes place to that price level. Thus there may come about a more or less permanent re-stratification of relative prices. (See Keynes's *Treatise*, Vol. I, pp. 89-94, for a brilliant discussion of this phenomenon.)

The next proposition is that the rise in prices will not be communicated to costs of production except to a very small extent. Cost of living may rise to some perceptible extent, as the retail price level must rise in a less elastic manner than the wholesale price level. But there is no automatic machinery anywhere causing wages to rise in consequence in this country, as in most; and, moreover, so far as India is concerned, wages are usually a part of the residual income of the agriculturist, not his out-goings. Land revenue, rent, irrigation, interest on past debt—these are fixed contractual items. The agriculturist in India does not live on imports, nor does his capital equipment consist of imported implements to the extent commonly supposed; thus if imports are slightly dearer, he *will not* be hurt. We can rest assured that the tears which the Government sheds for the

poor agriculturist are either tears of innocents or the tears of crocodiles. As regards industries, some elements of costs would rise, but total costs per unit cannot rise in the same proportion as prices and there will emerge a legitimate margin for expansion of population or at least the negative margin of loss will be wiped out. Even if the latter happens, it will be a great thing. There is another obsession that haunts some of us, *viz.*, the fear that the middleman might pocket all the profits at the expense of the producer; this fear is meaningless, because, although the middleman can avail himself of a temporary lag between export prices and up-country prices, still as the War and post-War periods have shown, the rise in the prices of staples is very soon communicated to the producing centres owing to intense competition among the middlemen. The speed with which the price rise is communicated may further be improved by putting pep into the slow and somnolent machinery recently created for the Marketing Surveys etc.

(6) That there might ensue an uncontrollable inflation as a result of devaluation is the bugbear of some critics. Such critics, of course, draw partly upon their own imagination and partly on the post-War experience of hyper-inflations in Europe, which were caused by an unrestricted issue of paper currency for financing war. They

ignore, however, that there is a world of difference between controlled inflations or reflations (*e.g.*, those brought about in Australia, New Zealand, Japan and the United States during 1931-37), used as correctives for disruption of costs-prices quilibria, and such hyper-inflations. The best recipe for these valetudinarians is a careful perusal of the *World Economic Surveys* and *Monetary Reviews* published by the League of Nations in recent years.

(7) Then, there are those who tell us that devaluation cannot, at any rate, stimulate our exports. According to them, devaluation will only lead to the imposition of hostile tariffs by our customers and competitors. However, such critics

TABLE XI

MAIN EXPORTS OF INDIA

(expressed as % of total exports)

Cotton	21.47%
Jute (raw)	8.54%
Jute (manf.)	14.63%
Tea	12.35%
Grain etc.	7.73%
Seeds	6.43%
Metals etc.	4.82%
Leather	3.51%
Hides and Skins	2.57%
All other items	17.95%
Total	100.00

have not stopped to consider how far these fears have a realistic basis. If we refer to the figures for our exports, we shall see that our exports are almost wholly composed of raw materials and foodstuffs. (See Table XI.) If there are any countries in the world which would impose hostile tariffs against commodities such as these, considerably cheapened by devaluation, they must be really very foolish! Our exports are largely in demand in manufacturing countries of the world and surely such countries will be only too happy to get their raw materials cheaper! There were anti-dumping duties imposed on Japanese goods, in so far as Japan's exports consisted of competitive lines in manufactures and, therefore, harmful to the national economic structure; but did any country impose retaliatory tariffs against Australian products? In spite of hostile tariffs, however, Japan could expand her trade and improve her trade balances as figures below will show. What has happened in Japan also happened in Australia.

TABLE XII

JAPAN'S MERCHANDISE TRADE AND BALANCE

(IN MILLION YEN)

	1932	1933	1934	1935
Exports	1491.7	1992.3	2370.4	2863.5
Merchandise balance	−58.8	−53.4	−70.3	+141.4

TABLE XIII

AUSTRALIA'S MERCHANDISE TRADE AND BALANCE

(IN MILLION £ STERLING)

	1928-29	1929-30	1930-31	1931-32	1932-33	1933-34	1934-35	1935-36
Exports ..	139.1	96.2	77.3	76.8	79.7	91.9	83.4	100.0
Balance in merchandise ..	—9.3	—40.4	+14.7	+31.0	+21.0	+30.6	+ 8.7	+13.7

However, whether or not devaluation stimulates our foreign trade (and neither in theory nor in practice, can there be any doubt that foreign trade, as a whole, *is* stimulated), the stimulus which devaluation gives to prices and production internally is, I think, of a vastly greater importance and it is likely to be all the more so in a country where internal trade is of superior importance. No one claims that devaluation would achieve miracles in India, but it is certainly capable of undoing the wrongs which have been done during the last two decades in the name of exchange stability to our economy and to our well-being.

CHAPTER NINE

CONCLUSION

THE conclusion at which we arrive from the foregoing discussion is mainly that the *Government must now revise its monetary policy either in the direction of de-linking the rupee from sterling or in that of devaluation in order to safeguard our foreign trade, to correct our balance of indebtedness and to take the load off our structures of prices and production with a view to greater employment and greater national income.* Moreover, de-linking or devaluation in itself would not be sufficient to increase our national efficiency either in agriculture or industry, and *does not certainly stand in the way of or preclude other measures.* If we would bring about an economic revival and regeneration of India, I feel that it will have to be

a frontal attack in several directions: extensive provision of rural credit; better facilities for industrial financing; public works and unemployment relief, to encourage the rate of investment and the propensity to consume in a cumulative manner; a carefully planned policy of industrialisation through fiscal and financial measures;—these are some of the items in a national programme to lift up the Gargantuan price and production structures of India out of the present morass. The problem of rural credit, to which lip sympathy has been given from time to time by the Government and the Reserve Bank authorities still awaits a solution. The Reserve Bank's weekly return still makes a miserable reading as regards the bill-market programme. Tentative proposals made by the Reserve Bank authorities are still to be implemented. And yet, while every other phase of our credit system is regulated by law, this area of rural financing remains a *terra incognita*, officially ignored, statistically non-existent. So long as the Government and the Bank fight shy of this great task of galvanising the internal credit system of the country, not only will their control of the money market remain superficial and ineffective, but the enormous rural debt must continue to be a load—increasing at a very high compound rate of interest from year to year,—round the neck of agriculture.

Thus, the currency and financial programme

which should be immediately undertaken by the Government of India and, in so far as lies in their power, by the Provincial Governments, may be tabulated as follows:—

1. De-linking of the rupee from sterling with a view to monetary independence, so as to suit the requirements of the price and production structures of India which are wholly different from those of the sterling country.

2. If de-linking is not feasible, immediate devaluation of the rupee (not necessarily to 16*d.*) so as to bring about a rise in the commodity prices in India up to the level at which an equilibrium with costs may be presumably attained.

3. Currency and credit expansion so as to realise the ideal of *full employment* in a progressive manner.

4. Extension of credit facilities for agriculture and industry through the regular machinery provided by the Reserve Bank and controlling of the usurious rates of interest, which are prevalent in the country, through the provision of an effective supply of cheap credit.

5. A well-planned public-works programme, as a second line of defence.

6. A programme of deficit budgeting, if need be, so as to tone up an economy which has been habitually working at low pressure.

7. Correction of the balance of trade with

a view to the full utilisation of the exports of gold towards debt cancellation and industrial financing rather than towards payment of income items like home charges, interest and other services.

I would conclude by saying that those who would set (*a*) producers against the wage-earners and consumers, (*b*) the middlemen against the producers, (*c*) the creditors against the debtors, (*d*) the industrialists against the agriculturists, (*e*) the town against the village, and (*f*) one Province against another, are really like the Six Blind Men of Hindosthan of the poem, who went to "see" the elephant and came back with six different impressions of that animal. No economist worth his salt would ever shut his eyes to the wider and greater interests of the nation *as a whole* and besmirch his fair name with quibblings such as these; for, when the doubtful theoretical triumph and the Pyrrhic victory of the day are over, there would still remain the less flippant and more onerous task of delivering a true, unbiased and scientific judgment on this important national issue.

POST-SCRIPT

The Congress and its Governments have in recent months made the monetary question their own and treated it as one of the planks of their programme. It is unfortunate that the Government of India have thought fit to turn down the representations of the Congress Governments with such scant courtesy. In a *communiqué* recently issued by them, the Government state :—

"The Government wish to make it clear that they have no intention to allow a lowering in the present exchange value of the rupee. On the contrary, they intend to defend it by every means in their power and are confident of their entire ability to maintain it. It is said that since their previous declaration on June 6, 1938, the balance of trade has turned more and more against India. The fact is that every month since June the balance of trade even excluding the treasure,

has been in favour of India and to some extent greater than in the corresponding month in the previous year. It is said that the sterling resources of India, particularly those of the paper currency reserve, have been used up to an alarming extent. The facts are that the assets of the paper currency reserve were merged in those of the Reserve Bank in April 1935 and the gold and the sterling resources of the Bank are as high now as they were at the time of its inception and are, in any event, more than 50 per cent of the total liabilities as opposed to the statutory requirement of, 40 per cent only.

"Moreover, since the inception of the Bank, 60 crores of sterling debt has been repatriated. It is said that 1*s*. 6*d*. ratio has hit the agriculturist hard by lowering the prices of agricultural commodities. The fact is that since June last the trend of the price index of chief articles of export has been definitely upwards. The Government of India are convinced that a lowering of the ratio in the existing international market conditions would produce an immediate rise in the cost of what he buys (!). It would also seriously weaken the budgetary position of the Central Government and the Provincial Governments. In fact, a lowering of the ratio would do no good to anybody (?) except the monied speculative interests, who profit from conditions of uncertainty and disturbance or who secure an additional but an unseen all-round increase of 12½ per cent in the protection afforded to them at the expense of the consumer.

"Altogether, the Government of India have no doubt that it is their clear duty in the interests of India generally and cultivator in particular to defend the present ratio to their utmost power. As already stated, they have every belief in their ability to do this and they are confident that drastic measures for contraction will not be necessary except to the extent they are forced upon them by the action of

speculators who place their funds abroad in the hope of bringing them back at a profit. Incidentally, they are convinced that the exchange would materially be stronger today, were it not for the fact that there have been large movements of funds to the United Kingdom by these same speculative interests during the last year."

As this communiqué was available to me after the book went to press, I propose to examine the contentions of the Government of India in this Post-Script very briefly. It makes no difference to the argument that the Congress Working Committee's resolution, which inspired this communiqué, is not exactly a scientific exercise, as I believe an impregnable case for devaluation could have been made, if the Working Committee had planned the resolution more laboriously and with meticulous care.

I. Firstly, then, the Government claim that since June 1938 "the balance of trade has been in favour of India and, to some extent, greater than in the corresponding months in previous years." Here are the figures for the eight months, April-November, for 1936, 1937 and 1938.

TABLE XIV

(IN LAKHS OF RS.)

Month		Balance of Trade in Merchandise	Balance of Trade in Treasure	Total visible balance of trade
April	1936 ...	+5,31	+189	+720
	1937 ...	+1,84	+149	+333
	1938 ...	−77	+105	+28
May	1936 ...	+4,45	+101	+546
	1937 ...	+2,26	+104	+330
	1938 ...	−42	+63	+21
June	1936 ...	+3,69	+140	+509
	1937 ...	+3,98	−25	+373
	1938 ...	+72	+50	+122
July	1936 ...	+4,37	+301	+738
	1937 ...	+3,20	+187	+507
	1938 ...	+3,64	+291	+655
August	1936 ...	+4,93	+135	+628
	1937 ...	+1,92	+103	+295
	1938 ...	+3,17	+188	+505
September	1936 ...	+5,63	+124	+687
	1937 ..	+3,40	+77	+417
	1938 ...	+4,86	−5	+481
October	1936 ...	+5,93	+229	+822
	1937 ...	+1,69	+123	+292
	1938 ...	+1,65	+184	+349
November	1936 ...	+6,83	+105	+788
	1937 ...	−76	+109	+33
	1938 ...	+1,96	+72	+268

The most obvious conclusion which emerges from the above Table is the poverty of our recent balances in merchandise trade, as compared to, say, pre-stabilisation balances shown in the Table in the Chapter on Balances of Payments. It is no doubt true that the merchandise balance slightly improved between June and September 1938, owing to the war scare and the munition programmes of the European countries. If the balances improved to a microscopic extent, as a result of world-wide forces of recovery, the credit is surely not due to the Government for its *exchange* policy. If a correct parity were chosen, the position would have been still better. But from September 1938 onwards, a rot has set in again and with the turning tide of recession, the balances promise progressive emaciation. However, there are three questions that may be put to the Government's experts: (1) Firstly, is it a matter of jubilation that "the balance of trade has been in *favour* of India, when we remember that the debtor position of the country requires not merely a *plus* balance but large favourable balances from year to year to meet "the charges"? (2) Secondly, why do they compare the monthly balances of trade for 1938 with 1937 only and not with 1936 and previous years, say, 1923-1931, which procedure would throw a comprehensive light upon the deterioration caused by the ratio? (3) Thirdly, what show do the figures

make as regards the "total visible balance of trade" (last column in the above Table), which is far more relevant to the management of ratio than the merchandise balance taken by itself? Is it not a fact that since July 1938 this has been falling disastrously, month by month, and that the ebb-tide has again set in?

II. Turning to the assets of the Reserve Bank, the Government assert that there has been no using-up of the Bank's resources for the maintenance of the ratio. I have dealt with this matter in the text more amply. Here I would only point out that the assets of the Bank were built up recently by a portion of the gold exports, out of Rs. 325 crores of gold nearly Rs. 200 crores being squandered away on current requirements and the remaining balance employed in building up the sterling balances and in cancelling some debt. Is it such a praiseworthy achievement that Rs. 60 crores worth debt has been repatriated under these circumstances? And what about sterling balances in London which are being frittered away from week to week in maintaining the ratio? The balance-sheet of the Bank is veritably a monument of progressive bankruptcy which is sustained only by the depletion of India's private gold reserves. A very, very narrow view of the assets of our monetary authorities before and after the establishment of the Bank, without reference to *national* monetary events,

would no doubt conceal the real state of affairs. But such a view is dangerously deceptive.

III. I do not repeat my arguments from the text in regard to the bogy of speculation, and the Government's boast of their "ability" to maintain the ratio. Only two points, however, may be made here; one about the incidental protection of $12\frac{1}{2}\%$ (or whatever is the degree of devaluation), and the other about the Government's budgetary position. There is no doubt that devaluation will give an incidental protection to the Indian industry; but I do not think that this will be altogether undeserved, seeing that the artificial rigging-up of the ratio after the war, above the pre-war level, has produced just the opposite effect of reducing the value of the present protection and putting a premium on *imports*. Devaluation would only correct this tendency. But apart from all this, as India's competitors have themselves lowered their exchanges everywhere and reduced the value of our protection, such correction becomes all the more necessary. As regards the budgetary position, it has been irrefutably proved in the text that this will not be affected at all, if all the factors are taken into consideration and a long view is maintained. However, why should we look merely at the Government of India's budget and care for the addition of a comparatively small burden of a couple of crores or so, when the *Reserve Bank* itself is an-

nually squandering crores of rupees of national assets in propping up the ratio? Dispassionate logic requires that both the Government's and the Bank's responsibilities are correctly assessed. In my view, the Government's burden will be more than balanced by the relief provided to the Bank's balances (which must accumulate in enormous quantities owing to freedom from responsibility for maintaining an unnaturally high ratio), and the relief provided to the national economy, as a whole, in the production of greater wealth in response to higher prices?

IV. Then, on the question of costs and prices, the *communiqué* makes the astounding revelation that the agriculturist's prices will not rise but that his costs alone would rise! Any tyro, however, would admit that the international *rupee* price level must rise immediately to the same extent as the degree of devaluation; to deny this would be to deny the rules of Arithmetic and the very truism of the purchasing power parity theorem. On the contrary, it is a travesty both of facts and theories to say that costs, i.e., the out-goings of the cultivator, which are fairly rigid, as shown in the text, would rise to any material extent.

We are also informed that the trend of export prices has been definitely upwards since June last. However, I reproduce below figures for the Calcutta wholesale prices, as well as the price indices

for exports and imports during 1937-38 and the first six months of 1938-39.

TABLE XV

CALCUTTA WHOLESALE PRICES

(Base : July 1914 = 100)

Months	1937-38 (1)	1938-39 (2)	% Change (+or—) of (2) over (1)
April	103	94	—9
May	103	94	—9
June	102	94	—8
July	104	95	—9
August ..	105	94	—10
September ..	104	95	—9
October ..	104	95	—9
November ..	103		
December ..	101		
January ..	90		
February ..	97		
March	96		

TABLE XVI

DECLARED VALUES OF EXPORTS AND IMPORTS

(Base : 1913-14 = 100)

Months	Exports			Imports		
	1937-38 (1)	1938-39 (2)	% change of (2) over (1)	1937-38 (1)	1938-39 (2)	% change of (2) over (1)
April ..	76	71	−7	75	85	+13
May ..	80	68	−15	80	84	+5
June ..	81	75	−7	81	90	+11
July ..	86	76	−12	77	86	+12
August ..	88	76	−14	75	90	+20
September	87	76	−13	83	82	−1
October ..	83			74		
November	79			66		
December	74			80		
January ..	76			76		
February	72			74		
March ..	70			81		

From Tables XV and XVI, we get an idea not only as to the movement of prices during the months subsequent to June 1938, but also as regards the relative movements as compared to the previous year's prices and the ratio between import and export prices. I am not sure that the export prices are necessarily the only index of the agriculturist's prosperity, even if this alone is taken as of national importance ; the wholesale prices, as a whole, whether for Calcutta, Bombay

or Karachi might be much more instructive. If we look at these general prices, what we find is a general stagnation of prices since January 1938. The Calcutta wholesale index has been steady at 95 between June to October 1938. Moreover, if we turn to the last column of Table XV, we find that the prices have fallen to about 9 % to 10 %, as compared to the corresponding months of the previous year. Is this a matter for congratulation? The Government *communiqué* makes much of the rise of export prices since June 1938. However, here also it conceals more than it reveals, because the slight rise after June 1938 has not promised continuance since October 1938; and here also it is strikingly remarkable that as compared to the previous year the fall has been considerable, between 7 % and 15 %. Is this the situation which is helpful to agriculture? The Government's experts probably thought that they could twit the Working Committee of the Congress by juggling the figures and by putting the Congress in the wrong on an insignificant detail in regard to which the resolution made an excusable mistake. I suppose the Government's experts do not need to be reminded that from the point of view of the agriculturist, what matters is not a slight rise in the price but a complete rehabilitation of his cost-prices equilibrium. Leave aside comparison with earlier years, especially the pre-stablisation years,

even comparison with the previous year shows a serious deterioration. How is it that the Government *communiqué*, which so meticulously compares the balance of trade for each month since June 1938 with the corresponding month in the previous year, forgets to apply the same method to the export prices, of which it makes so much?

However, let us turn to another aspect of this question. From Table XVI, it is apparent that the prices of imports during the same period have risen indicating a fall in India's "real ratio of trade," owing to the combined action of a fall in the prices of exports and a rise in those of imports.

TABLE XVII

REAL RATIO OF TRADE

(Export Prices ÷ Import Prices)

Months	1937-38 (1)	1938-39 (2)	% Change of (2) over (1)
April	101	83	—18
May	100	81	—19
June	100	83	—17
July	112	88	—23
August ..	117	84	—28
September ..	106	93	—12
October ..	112		
November ..	119		
December ..	192		
January ..	100		
February ..	98		
March ..	87		

It is rather interesting that the Government *communiqué* which has been so solicitous of the consumptional interests of the agriculturist should so suddenly forget that the figures for imports have registered such a rise during the period under review that the agriculturist, as a consumer, has been severely hit. As regards the contention of the *communiqué* that devaluation might hurt the agriculturist as a consumer, I have dealt with this question fully in the text.

To sum up, the Government *communiqué* is nothing but a tissue of incoherent arguments, supported by the well-known devices of *suppressio veri* and *suggestio falsi*. The extreme haste in which it was drafted as a reply to the Congress Resolution, suggests that the relevant statistics and underlying conditions of the period were not digested by the authors of the *communiqué*. If the Government feel that they have a case against devaluation, they owe it as a courtesy to the academical and business world, and as a justification of their own moral and intellectual credentials, that they should now either themselves undertake a detailed and honest investigation of the whole monetary question, or get it done by an impartial committee of experts. Stray and irresponsible *communiqués* most certainly are not calculated to bring credit to them.

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